
COMMENT

THE PLAIN MEANING OF SECTION 365(c): THE TENSION
BETWEEN BANKRUPTCY AND PATENT LAW
IN PATENT LICENSING

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INTRODUCTION

This Comment examines the underlying tension between bankruptcy law and intellectual property law in the context of nonexclusive patent licenses. The tension arises when a patent owner (i.e., a licensor)¹ grants a license for its patent and the licensee² files for bankruptcy under Chapter 11 of the United States Bankruptcy Code³ while the license is still in effect. In a traditional Chapter 11 filing, the debtor-licensee assumes an asset (here, the patent license) by becoming a debtor-in-possession⁴ and is then free to assign the asset to another

¹ The terms “patent owner” and “licensor” are used interchangeably throughout this Comment.

² For the purposes of this Comment, the licensee will always be the debtor party filing for bankruptcy.

³ Chapter 11 filings are typically used by businesses seeking reorganization. See 11 U.S.C. § 1101 (2006); WILLIAM D. WARREN & DANIEL J. BUSSEL, *BANKRUPTCY* 22 (8th ed. 2009) (“Chapter 11 may be used by both individuals and firms, but is designed primarily for business firms.”).

⁴ Section 1107 of the Bankruptcy Code provides that a debtor-in-possession has the rights, powers, and fiduciary obligations of a standard Chapter 11 trustee. See 11 U.S.C. § 1107. For a definition of a Chapter 11 trustee, see *infra* note 42 and accompanying text.

entity in order to facilitate its restructuring and reorganization plan.⁵ From the licensor's perspective, however, the debtor-licensee is not free to assign the license because it is nontransferable. Furthermore, patent law's fundamental "right to exclude" principle allows the patent owner to sue for patent infringement in the absence of a license agreement.⁶ Thus, the question becomes whether a debtor-licensee should be allowed to continue operating under its license once it files for bankruptcy, or if a conflict in bankruptcy and patent law should prevent the debtor-licensee from assuming and using the license. If the debtor-licensee's ability to use an essential asset is subject to conflicting law, then neither the licensor nor the licensee can be sure of its rights.

With technology at the forefront of today's economy, many companies increasingly rely on technology licenses in order to conduct their businesses. Unsurprisingly, the right to continue using intellectual property licenses—in particular, patent licenses—is critical to the survival of a distressed debtor. Most importantly, the debtor-licensee's assured ability to assume and assign the license will determine whether it will be able to successfully obtain financing or even continue operations after undergoing a Chapter 11 filing.

Part I of this Comment outlines the considerations of Chapter 11 bankruptcy law relating to patent licenses and a debtor-licensee's interests. Part II identifies the competing interests of patent law. Part III explores the various approaches courts have taken to address the conflict between bankruptcy and patent law, focusing on the development of the two main tests that courts have adopted to resolve the conflict. In addition, Part III examines the recent case law trends in some bankruptcy courts. Part IV investigates the statutory interpretation and legislative history of section 365(c) of the Bankruptcy Code and focuses on why the literal reading of the statute should prevail. Part V discusses how the literal reading of section 365(c) enables patent rights to be a form of creditor protection against the competing interests of a strong bankruptcy policy.

⁵ In bankruptcy law, assumption and assignment of patent licenses are governed by 11 U.S.C. § 365 because patent licenses are considered "executory contracts." See *infra* Part I.

⁶ 35 U.S.C. § 154(a)(1) (2006); DAVID A. BURGE, PATENT AND TRADEMARK: TACTICS AND PRACTICE § 11-7, at 124 (3d ed. 1999).

I. EXECUTORY CONTRACTS IN BANKRUPTCY LAW

A. *Contracts as Property of the Bankruptcy Estate*

Bankruptcy law relies on the concept of freely assignable rights of property in order to facilitate the restructuring and reorganization of the debtor.⁷ In particular, Chapter 11 of the Bankruptcy Code tries to preserve the ongoing value of the business and maximize the economic return to all constituents of the business.⁸ At its heart, a business is no more than a series of contracts enabling the development, production, or sale of a good or service. Putting aside a company's physical assets (e.g., land, buildings, equipment, inventory), the majority of a company's value comes from its contracts with its creditors, distributors, suppliers, customers, and the like.

Section 541 of the Bankruptcy Code provides that a bankruptcy estate is created upon the filing of a bankruptcy petition.⁹ The bankruptcy estate is considered to have a separate legal existence than that of the debtor who filed the case.¹⁰ The Bankruptcy Code defines "property of the estate" as all of the debtor's legal and equitable interests in property as of the bankruptcy petition's filing date.¹¹ Courts have interpreted a debtor's bankruptcy estate to include the debtor's contractual rights.¹² In the case of a debtor business filing for Chapter 11, the bankruptcy estate includes the debtor's physical assets as well as the debtor's contracts with any creditors, distributors, suppliers, customers, and the like.¹³

⁷ See 3 RESTATEMENT (SECOND) OF CONTRACTS § 317(2) (1981) (allowing for the assignment of contractual rights except in specific cases such as illegality or undue hardship); see also *Shaw Group, Inc. v. Bechtel Jacobs Co. (In re IT Group)*, 350 B.R. 166, 177 (Bankr. D. Del. 2006) ("The [Bankruptcy] Code generally favors free assignability as a means to maximize the value of the debtor's estate and, to that end, allows the [debtor] to assign notwithstanding a provision in the contract or lease, or applicable law, prohibiting, restricting, or conditioning assignment." (second alteration in original) (internal quotation marks omitted) (quoting *L.R.S.C. Co. v. Rickel Home Ctrs., Inc. (In re Rickel Home Ctrs., Inc.)*, 209 F.3d 291, 299 (3d Cir. 2000))).

⁸ See, e.g., *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983) (discussing the principles behind the reorganization provisions of the Bankruptcy Code and how "Congress anticipated that the business would continue to provide jobs, to satisfy creditors' claims, and to produce a return for its owners").

⁹ 11 U.S.C. § 541(a).

¹⁰ *Id.*

¹¹ See *Whiting Pools*, 462 U.S. at 203 (viewing section 541(a)(1) as "a definition of what is included in the estate, rather than as a limitation").

¹² See, e.g., *Quarles House Apartments v. Plunkett (In re Plunkett)*, 23 B.R. 392, 394 (Bankr. E.D. Wis. 1982) (noting that courts have interpreted section 541 as "protect[ing] a debtor's contractual right as an asset of the estate").

¹³ 11 U.S.C. § 541(a).

B. *Patent Licenses as Executory Contracts*

The conflict between intellectual property and bankruptcy law arises from the Bankruptcy Code's treatment of a special type of contract, known as an "executory contract," under section 365.¹⁴ Any contracts that require, at the time of the bankruptcy petition filing, further performance from each party are considered executory.¹⁵ In particular, nonexclusive licenses, such as those commonly found in patent licenses, are considered executory contracts within the meaning of the Code.¹⁶ This is because both parties have continuing obligations—in the case of a nonexclusive patent license, the licensor has a continuing obligation not to sue the licensee for infringement of its patent, and the licensee has a continuing obligation to commercialize the licensed invention.¹⁷

With executory contracts, a debtor has three options: (1) rejection of the contract, (2) assumption of the contractual obligations, or (3) assignment (i.e., transfer) of the contract.¹⁸ The ability to freely choose

¹⁴ An executory contract is "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973); see also *Sharon Steel Corp. v. Nat'l Fuel Gas Distribution Corp.*, 872 F.2d 36, 39 (3d Cir. 1989) (adopting Countryman's definition of "executory contract").

¹⁵ See Unsecured Creditor's Comm. of Robert L. Helms Constr. & Dev. Co. v. Southmark Corp. (*In re Robert L. Helms Constr. & Dev. Co.*), 139 F.3d 702, 705 (9th Cir. 1998) (defining an "executory contract" as one where both parties continue to have obligations under the contract such that failure to perform an obligation would be a material breach that would justify the other's nonperformance).

¹⁶ See, e.g., *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.* (*In re Richmond Metal Finishers, Inc.*), 756 F.2d 1043, 1045 (4th Cir. 1985) (holding that a non-exclusive patent license was an executory contract based on the "unperformed, continuing core obligations of notice and forbearance in licensing").

¹⁷ See David R. Kunej, *Restructuring Dilemmas for the High Technology Licensee: Will "Plain Meaning" Bring Order to the Chaotic Bankruptcy Law for Assumption and Assignment of Technology Licenses?*, 44 GONZ. L. REV. 123, 135 (2008) (noting that in bankruptcy, patent licenses "are almost uniformly regarded as executory contracts"); Ann Livingston & Leif M. Clark, *Technology Transfers: What if the Other Party Files Bankruptcy?*, 21 ST. MARY'S L.J. 173, 180-81 (1989) ("In the context of technology transfers, most agreements will include continuing rights and duties by both parties and will be considered executory."); Robert L. Tamiotti, *Technology Licenses Under the Bankruptcy Code: A Licensee's Mine Field*, 62 AM. BANKR. L.J. 295, 301 (1988) ("[A] [patent] license must be executory throughout its term. Each day the licensee uses the licensor's technology, the licensor forebears its right to sue the licensee for conduct that 'but for the license, would be an infringement.'" (quoting *United States v. Studiengesellschaft Kohle, m.b.H.*, 670 F.2d 1122, 1127 (D.C. Cir. 1981))); see also *infra* Part II.

¹⁸ See 11 U.S.C. § 1123(b)(2) (declaring that a debtor's plan may, subject to section 365, "provide for the assumption, rejection, or assignment of any executory contract").

and exercise these three options is fundamental to a debtor's ability to maximize the value of its assets during reorganization or restructuring.

1. Rejection of an Executory Contract

The first option, rejection, is relatively straightforward. The debtor simply rejects the contracts it deems to be of low value or highly cumbersome to operate.¹⁹ Under section 365(g) of the Bankruptcy Code, the debtor's trustee,²⁰ with the approval of the bankruptcy court, may reject an executory contract.²¹ This rejection constitutes a breach of the contract, effective immediately prior to the debtor's bankruptcy filing.²² In technology licensing cases, section 365(n) of the Bankruptcy Code provides a remedy for breach of contract if the debtor party is the *licensor*—in these cases, the nondebtor party may treat the license as terminated.²³ Similarly, if the debtor party is the

¹⁹ Section 365(g) of the Bankruptcy Code governs the rejection of an executory contract. In order to reject an executory contract, the debtor must file a motion with the bankruptcy court. FED. R. BANKR. P. 9014(a); *see also* 11 U.S.C. § 365(d) (listing the timing requirements for such a motion). The court will consider the debtor's motion for authority to reject an executory contract using the "business judgment rule," which focuses on whether rejection of the executory contract would benefit the general unsecured creditors of the debtor's estate. *See, e.g.,* Robertson v. Pierce (*In re* Chi-Feng Huang), 23 B.R. 798, 800-01 (B.A.P. 9th Cir. 1982) ("We believe rejection of the burdensome test in favor of the 'business judgment' rule is dictated by logic as much as precedent. . . . The primary issue is whether rejection would benefit the general unsecured creditors."). Under the business judgment rule, the court will give great deference to the debtor's decision to reject the contract and will not interfere with the decision unless there is a showing of bad faith or abuse of discretion. *See* Group of Institutional Investors v. Chi., Milwaukee, St. Paul & Pac. R.R., 318 U.S. 523, 550-51 (1943) (holding that the Court will not upset business judgment "except on a clear showing that the limits of discretion have been exceeded").

²⁰ The debtor-in-possession also has the ability to assume, reject, or assign an executory contract. *See infra* note 42 and accompanying text.

²¹ 11 U.S.C. § 365(g).

²² *Id.*; *see also* Agarwal v. Pomona Valley Med. Group, Inc. (*In re* Pomona Valley Med. Group, Inc.), 476 F.3d 665, 671 (9th Cir. 2007) (holding that the debtor's rejection of the executory contract "constituted a breach of that contract effective immediately before [the debtor] filed for bankruptcy").

²³ *See In re* EI Int'l, 123 B.R. 64, 66 (Bankr. D. Idaho 1991) ("The option consists of the licensee choosing either to terminate the agreement or to retain the rights to performance by the other party under the agreement."). Notably, Congress amended the Bankruptcy Code after the Fourth Circuit's decision in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.* (*In re* Richmond Metal Finishers, Inc.), 756 F.2d 1043 (4th Cir. 1985). In *Lubrizol*, the court recognized the difficulties that a licensee would face if the debtor-licensor rejected (and thus terminated) the patent license, noting that the possibility of rejection could have a "chilling effect" on intellectual property licensing by companies that did not have the strongest financial position. *Id.* at 1048. Recognizing the importance of intellectual property licenses, Congress passed the Intellectual

licensee, rejection of the license allows the nondebtor party to treat the license as terminated.²⁴ Thus, regardless of whether the debtor is the patent licensor or licensee, if the debtor chooses to reject the license, the license will be deemed terminated.²⁵

2. Assumption of an Executory Contract

The situation becomes more complex if the debtor party wishes to assume and assign the license as a patent licensee, due to bankruptcy's protections of a debtor's interests and estate. In Chapter 11 filings, the assumption and assignment of an executory contract fundamentally affects the debtor's ability to restructure.²⁶ The debtor will want to assume the contracts it deems to be valuable and, upon assumption, retain the contracts as part of its reorganization.²⁷ Since a patent license authorizes the debtor-licensee to operate under the terms of the license, the debtor-licensee will likely assume the license in order to continue its business operations during bankruptcy. For example, a debtor may be in the business of manufacturing widgets and has licensed a patent enabling it to produce the widget. After filing for bankruptcy, if the debtor wishes to be able to continue its business operations and (hopefully) make a profit, it must assume the patent license in order to continue manufacturing the widgets legally, or risk being sued for patent infringement by the patent owner.

Property Bankruptcy Protection Act of 1988, which provides that licensees of "intellectual property" (as defined in the Code) have the option to retain certain rights under the license even in the face of the debtor-licensor's rejection. Pub. L. No. 100-506, sec. 1(b), § 365(n)(1), 102 Stat. 2538, 2538 (codified as amended at 11 U.S.C. § 365(n)). For a discussion of section 365(n) and the impact of a license rejection by a debtor-licensor, see SHARON K. SANDEEN, *INTELLECTUAL PROPERTY DESKBOOK FOR THE BUSINESS LAWYER* 179-81 (2d ed. 2009).

²⁴ 11 U.S.C. § 365(g).

²⁵ For a discussion of the choices a licensor and licensee have when a license is rejected, see Livingston & Clark, *supra* note 17, at 191, 207.

²⁶ See 11 U.S.C. § 365(f) (restricting the ability to modify any "contract, lease, right or obligation" due to its assumption or assignment).

²⁷ See Peter S. Menell, *Bankruptcy Treatment of Intellectual Property Assets: An Economic Analysis*, 22 BERKELEY TECH. L.J. 733, 737 (2007) (noting how the bankruptcy system "seeks to maximize the value of the remaining assets and capacities of the troubled entity" by "afford[ing] trustees and debtors substantial leeway to rescind contracts and reorder the affairs of the entity"); Madlyn Gleich Primoff & Erica G. Weinberger, *E-Commerce and Dot-com Bankruptcies: Assumption, Assignment and Rejection of Executory Contracts, Including Intellectual Property Greements [sic], and Related Issues Under Sections 365(c), 365(e) and 365(n) of the Bankruptcy Code*, 8 AM. BANKR. INST. L. REV. 307, 314 (2000) ("[T]he purpose of section 365 of the Bankruptcy Code is to permit the trustee to retain or assign valuable contracts and to abandon burdensome contracts . . .").

The specific requirements for assuming a contract are governed by section 365(b) of the Bankruptcy Code. The main conditions are that the debtor must assure the court of its “ability to cure past defaults and meet future obligations.”²⁸ These two conditions are intended to ensure that the nondebtor party, who is forced to continue performance, receives the full benefit of its bargain.²⁹ In the case of a patent license, because the licensor is foregoing its right to sue the licensee for conduct that “but for the license, would be an infringement,”³⁰ the licensor must be assured that the debtor-licensee is in a position to fulfill the commercialization terms of the patent license.³¹

When a debtor assumes a contract, the debtor’s estate becomes obligated to take on the contract in its entirety.³² The debtor cannot pick and choose parts of the contract it wishes to assume.³³ Furthermore, upon assumption of the contract, the nondebtor party is given priority-claimant status for both previous and future amounts due under the

²⁸ Primoff & Weinberger, *supra* note 27, at 311; *see also* 11 U.S.C. § 365(b) (identifying the requirements that must be satisfied at the time of assumption).

²⁹ *See* S. REP. NO. 95-989, at 59 (1978), *reprinted in* 1978 U.S.C.A.N. 5787, 5845 (“If the trustee is to assume a contract . . . , the court will have to insure that the trustee’s performance under the contract . . . gives the other contracting party the full benefit of his bargain.”)

³⁰ *United States v. Studiengesellschaft Kohle, m.b.H.*, 670 F.2d 1122, 1127 (D.C. Cir. 1981); *see also* Tamietti, *supra* note 17, at 301 (quoting *Studiengesellschaft Kohle* in explaining how a patent license constitutes an executory contract).

³¹ *See* Clinton H. Neagley, *Patent Licensing for Small Agricultural Biotechnology Companies* (discussing commercialization milestones in negotiating patent licenses), in 2 INTELLECTUAL PROPERTY MANAGEMENT IN HEALTH AND AGRICULTURAL INNOVATION 1213, 1213-19 (Krattiger et al. eds., 2007). If the licensed invention is not practiced (i.e., through commercialization), the invention would be considered wasted. *See* Note, *Rights of the Owner of an Idle Patent in Equity*, 20 HARV. L. REV. 638, 638-39 (1907).

³² *See* *Tex. N. W. Ry. Co. v. Atchison, Topeka & Santa Fe Ry. Co.* (*In re* Chi. Rock Island & Pac. R.R. Co.), 860 F.2d 267, 272 (7th Cir. 1988) (noting that a “trustee cannot accept the benefits of an executory contract without accepting the burdens as well” (quoting *Schokbeton Indus., Inc. v. Schokbeton Prods. Corp.*, 466 F.2d 171, 175 (5th Cir. 1972))); *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1311 (5th Cir. 1985) (“[T]he often-repeated statement that the debtor must accept the contract as a whole means only that the debtor cannot choose to accept the benefits of the contract and reject its burdens to the detriment of the other party of the agreement.”); *Rockland Ctr. Assocs. v. TSW Stores of Nanuet, Inc.* (*In re* TSW Stores of Nanuet, Inc.), 34 B.R. 299, 304 (Bankr. S.D.N.Y. 1983) (holding that executory contracts cannot be accepted or rejected in part).

³³ *See In re Storage Tech. Corp.*, 53 B.R. 471, 475-76 (Bankr. D. Colo. 1985) (“[T]he Bankruptcy Code requires assumption of an entire agreement. Additionally, a debtor cannot avoid the effect of this rule by construing various parts of a transaction as separate agreements when they are clearly interdependent.” (citation omitted)).

contract.³⁴ Thus, the debtor's assumption of an executory contract elevates the noncreditor party over the debtor's other creditors.³⁵

3. Assignment of an Executory Contract

If the debtor assumes the contract but chooses not to retain it, then the debtor can elect to assign (i.e., transfer or sell) the contract.³⁶ Once the debtor has assumed the contract, it has the power to assign the contract to third parties.³⁷ A debtor might assign the contract in order to raise capital through financing or cash to pay its creditors. For example, in *In re Haven Eldercare*, the debtor, an operator of several nursing, assisted living, and residential care facilities, petitioned for authority to sell some of its facilities as part of its Chapter 11 reorganization plan.³⁸ As part of this sale, the debtor sought to assume and assign executory contracts and unexpired leases that were vital to the operation of these facilities.³⁹ The bankruptcy court held that assumption and assignment of the executory contracts and unexpired leases were vital to the operation of the nursing facilities being sold and thus integral to the debtor's restructuring proposal.⁴⁰ As *In re Haven Eldercare* demonstrates, the assignment of the executory contract can play an essential role in the debtor's restructuring or reorganization. The Bankruptcy Code recognizes the importance of this power and provides that the debtor's right to assign an executory contract overrides most non-bankruptcy law and contractual restrictions on assignment.⁴¹

³⁴ See 11 U.S.C. § 365(b) (2006).

³⁵ In a bankruptcy proceeding, creditors are repaid based upon the priority of their claims. Thus, the nondebtor party's elevation in priority status is a significant by-product of the debtor's assumption of the executory contract. See Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection,"* 59 U. COLO. L. REV. 845, 890 (1988) (stating that when a debtor assumes a contract, "the non-debtor party departs the ranks of ordinary creditors and becomes a priority claimant both for past-due and later-accruing amounts").

³⁶ Section 363 of the Bankruptcy Code states that "[t]he trustee, after notice and hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b). Normally, when a nondebtor has an interest in the same property, section 363(e) permits the trustee to sell, lease, or use the property after notice and hearing, provided that the nondebtor's interest is adequately protected. *Id.* § 363(e); see also *id.* § 361 (defining what constitutes "adequate protection" of an interest).

³⁷ See *id.* § 365(c), (f).

³⁸ 390 B.R. 762, 765 (Bankr. D. Conn. 2008).

³⁹ *Id.* at 765-69.

⁴⁰ *Id.* at 772.

⁴¹ This "free assignability" principle is set forth in section 365(f) of the Bankruptcy Code, which states, "Except as provided in subsections (b) and (c) of this section, not-

To assist the debtor entity in maximizing its value under reorganization or restructuring, many courts have interpreted the Code to allow the trustee or debtor-in-possession⁴² to assign most contracts regardless of contrary nonbankruptcy law or contractual provisions.⁴³ For example, in *In re U.L. Radio Corp.*, the debtor was in the business of selling and servicing televisions and had entered into a lease with its landlord to rent a storefront for its operations.⁴⁴ After the debtor filed for bankruptcy, it tried to assume and assign (i.e., sell) its lease to a third party to operate the space as a small bistro.⁴⁵ The bankruptcy court held that the lease could be assumed and assigned to the third party despite the “deviation in use . . . from an appliance store to a small bistro.”⁴⁶

In the context of patent licensing, because the bankruptcy estate is considered a separate legal entity than that of the debtor, an assumption of the license is also an assignment of the license, regardless of whether the debtor-licensee actually assigns the license to a third party.⁴⁷ When the debtor’s estate assumes the license, the estate also receives an assignment of the license. This automatic assignment creates an issue for the patent licensor because the licensee is no longer the same

withstanding a provision in an executory contract . . . of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract . . . , the trustee may assign such contract . . . under paragraph (2) of this subsection.” 11 U.S.C. § 365(f).

⁴² A trustee is an impartial person assigned by the court to oversee and administer the debtor’s bankruptcy process. *See id.* §§ 701, 704 (describing the role of a trustee in Chapter 7 bankruptcy filings). Most Chapter 11 bankruptcy cases, however, do not require appointment of a trustee. Instead, the business becomes a debtor-in-possession and continues to manage itself without an appointed trustee. *See id.* § 1107 (describing the rights and powers of a debtor-in-possession). In this Comment, I will use the terms “trustee” and “debtor-in-possession” interchangeably, unless otherwise explicitly noted.

⁴³ Assignments are governed by section 365(f) of the Bankruptcy Code. *See id.* § 365(f). Subsection (f)(1) “partially invalidates restrictions on assignment of contracts or leases by the trustee to a third party.” H.R. REP. NO. 95-595, at 349 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6305; S. REP. NO. 95-989, at 59 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5845. Subsection (f)(3) “invalidates contractual provisions that permit termination or modification in the event of an assignment, as contrary to the policy of this subsection.” H.R. REP. NO. 95-595, at 349, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6305; S. REP. NO. 95-989, at 59, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5845; *see also* 11 U.S.C. § 541(c) (codifying that despite a restriction on transfer or an ipso facto clause, “an interest of the debtor in property becomes property of the [debtor’s] estate”).

⁴⁴ 19 B.R. 537, 539 (Bankr. S.D.N.Y. 1982).

⁴⁵ *Id.*

⁴⁶ *Id.* at 544-45.

⁴⁷ This view is applied in what is known as the “hypothetical test.” *See infra* subsection III.B.1.

legal entity as it was prebankruptcy.⁴⁸ To better understand this issue, we must first examine the basic principles of patent law.

II. BASIC PRINCIPLES OF PATENT LAW

A. *The Balance Between Exclusivity and Disclosure*

Though the power of free assignability is paramount to bankruptcy law, it runs directly counter to the policies of exclusive use and monopolistic control in patent law. The Founding Fathers recognized the importance of strong patent rights by granting Congress the power “To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive right to their respective Writings and Discoveries.”⁴⁹ From this language, Congress developed exclusive-use policies in order to provide inventors and innovators with incentives to create.⁵⁰ By rewarding inventors and innovators with a period of exclusive use in exchange for disclosure of their creation, Congress furthered the societal advancement of knowledge.⁵¹

⁴⁸ The Supreme Court has suggested that a debtor and its successor debtor-in-possession should be treated as the same entity for purposes of applying the Bankruptcy Code. See *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984) (“[I]t is sensible to view the debtor-in-possession as the same ‘entity’ which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have employed absent the bankruptcy filing.”). Some courts, however, have read the Supreme Court’s comment as being “necessary only for the purposes of that case,” and have held that it “does not support in all cases the proposition that no assignment or transfer occurs as a matter of law between prepetition debtor and debtor in possession.” *Bonneville Power Admin. v. Mirant Corp.* (*In re Mirant*), 440 F.3d 238, 254 n.21 (5th Cir. 2006). Unfortunately, “neither the Supreme Court nor this Circuit has resolved the argument . . . that rights obtained in bankruptcy require that a debtor in possession be treated as a distinct legal entity from a prepetition debtor.” *Id.*; see also *infra* notes 211-13 and accompanying text.

⁴⁹ U.S. CONST. art. I, § 8, cl. 8.

⁵⁰ The Patent Clause has been implemented through a series of acts that set out the conditions for obtaining a patent; these are now codified in Title 35 of the U.S. Code. See Patent Act of 1952, ch. 950, 66 Stat. 792; Patent Act of 1922, ch. 58, 42 Stat. 389; Patent Act of 1836, ch. 357, 5 Stat. 117; Patent Act of 1793, ch. 11, 1 Stat. 318; Patent Act of 1790, ch. 7, 1 Stat. 109. In particular, 35 U.S.C. § 154(a) (2006) describes a patentee’s exclusive rights to her invention.

⁵¹ The word “patent” originates from the Latin *patere*, which means “to lay open” (for public inspection), and the term “letters patent,” which originally denoted royal decrees granting exclusive rights to certain individuals or businesses. See *Application of Bo Thuresson Af Ekenstam*, 256 F.2d 321, 323 (C.C.P.A. 1958) (discussing the origin of the word “patent”).

The Drug Price Competition and Patent Term Restoration Act of 1984,⁵² more commonly known as the Hatch-Waxman Act, is a recent example of Congress's attempts to balance the limited period of exclusivity with invention disclosure. The Hatch-Waxman Act was designed to promote generic drug manufacturing while preserving a financial incentive for the research and development conducted by pioneering drug companies (often brand-name pharmaceutical companies).⁵³ The Act allows generic drug companies to obtain marketing approval from the U.S. Food and Drug Administration (FDA) by submitting bio-equivalence studies of the drug compositions described in the pioneering drug company's patent application.⁵⁴ The Act also grants the pioneering drug company a period of additional marketing exclusivity of up to five years to compensate for the time the drug remains under review for regulatory approval.⁵⁵ Thus, in exchange for disclosing the drug, the pioneering drug company is rewarded with a period of market exclusivity.⁵⁶

A patent grants its owner the right to exclude others from practicing its teachings (i.e., the invention).⁵⁷ Through this exclusivity, patents create incentives for companies to engage in research and development.⁵⁸ Without the protection of patent rights, companies would not be willing to invest in research and development if third parties could simply copy their research and steal their profits.⁵⁹ In

⁵² Pub. L. No. 98-417, 98 Stat. 1585.

⁵³ See 130 CONG. REC. 23,764-65 (1984) (statement of Sen. Hatch).

⁵⁴ See Drug Price Competition and Patent Term Restoration Act of 1984, tit. I, 98 Stat. at 1585-97 (codified as amended at 21 U.S.C. § 355 (2006)) (discussing abbreviated new drug applications).

⁵⁵ See *id.* at tit. II, 98 Stat. at 1598-1603 (codified as amended in scattered sections of 35 U.S.C.).

⁵⁶ See *id.*

⁵⁷ See, e.g., *Herman v. Youngstown Car Mfg. Co.*, 191 F. 579, 584-85 (6th Cir. 1911) ("A patent is not the grant of a right to make or use or sell. It does not, directly or indirectly, imply any such right. It grants only the right to exclude others.").

⁵⁸ See Petra Moser, *How Do Patent Laws Influence Innovation? Evidence from Nineteenth-Century World's Fairs*, 95 AM. ECON. REV. 1214, 1214-15 (2005) (arguing that innovation must respond to profit incentives in order for patent laws to influence innovation and referencing empirical studies that establish innovation's responsiveness to incentives); Joseph A. DiMasi & Henry G. Grabowski, *Patents and R&D Incentives: Comments on the Hubbard and Love Trade Framework for Financing Pharmaceutical R&D 2* (June 25, 2004), <http://www.who.int/intellectualproperty/news/en/Submission3.pdf> (questioning the ability of alternatives to patent protection to provide sufficient coverage of research and development costs and thus the incentive to innovate).

⁵⁹ See, e.g., Howard T. Markey, *Special Problems in Patent Cases*, 66 F.R.D. 529, 532 (1975) (noting that patents provide both "the incentive to risk the investment of the large sums and long years of effort required to bring the invention into the market-

addition to large-scale funding, patent rights also enable small inventors,⁶⁰ in exchange for interests in the patent, to raise capital in order to bring inventions to market.⁶¹

B. *Two Types of Patent Interests: Assignments and Licenses*

An interest in a patent can be in the form of an assignment⁶² or a license.⁶³ The distinction between a patent assignment and license is not merely one of word choice but of legal effect.⁶⁴ A patent assignment is a transfer of an ownership interest in the patent.⁶⁵ As the Supreme Court stated in *Waterman v. Mackenzie*, there are three types of patent assignments:

The patentee . . . may . . . assign, grant and convey, either, 1st, the whole patent, comprising the exclusive right to make, use and vend the invention throughout the United States; or, 2d, an undivided part or share of

place at a reasonable price” and “the only deterrent to secrecy and the only marketplace for ideas we have”).

⁶⁰ Although most small or solo inventors qualify for “small-entity” status, and therefore are entitled to pay reduced patent fees, other types of nonprofit organizations also fall under this umbrella, including universities. See 35 U.S.C. § 41(h)(1) (2006) (reducing fees by fifty percent for small businesses, independent inventors, and nonprofits); 13 C.F.R. § 121.802(a) (2009) (providing that organizations with fewer than five hundred employees qualify for reduced patent fees). Note that small-entity status is lost when the patent is licensed, exclusively or nonexclusively, or assigned to an organization that would not qualify for small-entity status. 37 C.F.R. § 1.27(a)(2)(i) (2009).

⁶¹ See RICHARD STIM, *PROFIT FROM YOUR IDEA: HOW TO MAKE SMART LICENSING DECISIONS* 4/10-4/12 (5th ed. 2006) (discussing “angel investors” who acquire equity in businesses rather than giving loans).

⁶² As a matter of legal terminology, the term “assignment” has special meaning within both patent and bankruptcy law. For purposes of this Comment, an “assignment” is a bankruptcy assignment under section 365 of the Bankruptcy Code, and not a patent assignment of ownership of property. See *infra* note 66 for an explanation of patent assignments.

⁶³ One can also take an interest in a patent in the form of a lien. This occurs when the lienholder takes a security interest in the patent. See U.C.C. § 9-102(42) (2005) (defining “general intangibles” to include intellectual property by including personal property and software in the definition); see also Scott J. Lebson, *Security Interests in Intellectual Property in the United States*, at pt. VIII (2006), http://www.ladas.com/IPProperty/ipprop_securityinterests.html (discussing how, historically, liens on patents have been perfected via U.S. Patent and Trademark Office filings).

⁶⁴ See *Waterman v. Mackenzie*, 138 U.S. 252, 256 (1891) (“Whether a transfer of a particular right or interest under a patent is an assignment or a license does not depend upon the name by which it calls itself, but upon the legal effect of its provisions.”).

⁶⁵ See 35 U.S.C. § 261 (defining patent ownership and assignment).

that exclusive right; or, 3d, the exclusive right under the patent within and throughout a specified part of the United States.⁶⁶

The Court noted, however, that “[a]ny assignment or transfer, short of one of these, is a mere license, giving the licensee no title in the patent, and no right to sue at law in his own name for an infringement.”⁶⁷ Thus, when a patent owner licenses its patent to a licensee, the patent owner is effectively granting the licensee a promise not to sue for patent infringement.⁶⁸ The licensee has not gained “ownership” of the patent in any traditional sense of property,⁶⁹ because a license does not equal an assignment.⁷⁰ Simply put, a license is merely a covenant not to sue for infringement and not the transfer or conveyance of any property interest.⁷¹ Thus, the patent owner’s ability to choose and control which parties license its technology is tantamount to exercising its right to exclude.⁷² Without a valid license, the

⁶⁶ 138 U.S. at 255. The term “assignment” has a particular meaning in patent law, implying formal transfer of title. For example, if Inventor *A* assigns full rights of the patent to Company *X*, then Company *X* is the owner of the patent and has full rights, including the rights to enforce and license the patent. See 35 U.S.C. § 261; *Vaupel Textilmaschinen KG v. Meccanica Euro Italia S.P.A.*, 944 F.2d 870, 875 (Fed. Cir. 1991) (holding that in patent law, an assignment constitutes “a formal transfer of title”).

⁶⁷ *Waterman*, 138 U.S. at 255.

⁶⁸ See *Spindelfabrik Suessen-Schurr Stahlecker & Grill GmbH v. Schubert & Salzer Maschinenfabrik Aktiengesellschaft*, 829 F.2d 1075, 1081 (Fed. Cir. 1987) (“[A] patent license agreement is in essence nothing more than a promise by the licensor not to sue the licensee . . . [e]ven if [the promise is] couched in terms of ‘[I] licensee is given the right to make, use, or sell *X*. . . .’” (italics added) (citation omitted) (fourth alteration in original)); *W. Elec. Co. v. Pacent Reproducer Corp.*, 42 F.2d 116, 118 (2d Cir. 1930) (“In its simplest form, a license means only leave to do a thing which the licensor would otherwise have a right to prevent. Such a license grants to the licensee merely a privilege that protects him from a claim of infringement by the owner of the patent monopoly.”).

⁶⁹ Patents are treated as personal property. See 35 U.S.C. § 261 (“Subject to the provisions of this title, patents shall have the attributes of personal property.”).

⁷⁰ See *Waterman*, 138 U.S. at 255 (noting the differences between a patent assignment and a patent license); *Everex Sys., Inc. v. Cadtrak Corp.* (*In re CFLC, Inc.*), 89 F.3d 673, 679-80 (9th Cir. 1996) (concluding that nonexclusive patent licenses are considered to be personal rights that do not include any rights to assign or to sublicense unless expressly given by the licensor).

⁷¹ See *Tamietti*, *supra* note 17, at 301 (“A license simply insulates those who pay for use of proprietary technology from the costs of infringement litigation, and does not transfer rights of ownership in the subject technology.” (footnote omitted)).

⁷² See, e.g., *Heaton-Peninsular Button-Fastener Co. v. Eureka Specialty Co.*, 77 F.2d 288, 290-92 (6th Cir. 1896) (discussing the extent of a patent licensee’s interests and limitations).

practicing party has no authority to practice the patented invention and, therefore, is committing patent infringement.⁷³

C. *Exclusive Versus Nonexclusive Patent Licenses*

A patent owner can choose to grant the licensee an exclusive or nonexclusive license. In an exclusive license, the patent holder promises that it will neither exploit the patent itself, nor permit any use of the patent other than by the licensee.⁷⁴ A single patent can have multiple “exclusive licensees,” such that each licensee is granted exclusive rights to a portion of the overall patent rights. Such exclusive rights are often divided temporally, geographically, by field of use, by type of use, or on a claim-by-claim basis.⁷⁵ As a general rule, if an exclusive licensee wishes to bring forth an infringement suit, the patent holder must be joined, either voluntarily or involuntarily.⁷⁶ The courts, however, have regarded this rule “as being prudential rather than constitutional in nature,”⁷⁷ and thus subject to an exception in the case when “all substantial rights” in the patent are transferred.⁷⁸ Accordingly, when all substantial rights in the patent have been transferred to the licensee, the licensee has effectively become an assignee of the patent, and therefore has legal title to the patent.⁷⁹

⁷³ See 35 U.S.C. § 271 (a) (“[W]hoever without authority makes, uses, offers to sell, or sells any patented invention . . . infringes the patent.”).

⁷⁴ See, e.g., MICHAEL A. EPSTEIN, EPSTEIN ON INTELLECTUAL PROPERTY § 18.02[B] (5th ed. Supp. 2009) (discussing limitations that may be placed on grants of intellectual property licenses).

⁷⁵ See *Int’l Gamco, Inc. v. Multimedia Games, Inc.*, 504 F.3d 1273, 1276-79 (Fed. Cir. 2007) (describing various types of exclusive patent licenses).

⁷⁶ See, e.g., *Abbott Labs. v. Diamedix Corp.*, 47 F.3d 1128, 1131 (Fed. Cir. 1995) (“A licensee may obtain sufficient rights in the patent to be entitled to seek relief from infringement, but to do so, it ordinarily must join the patent owner.”).

⁷⁷ *Prima Tek II, L.L.C. v. A-Roo Co.*, 222 F.3d 1372, 1377 (Fed. Cir. 2000).

⁷⁸ *Int’l Gamco*, 504 F.3d at 1277-78.

⁷⁹ See *Enzo APA & Son, Inc., v. Geapag A.G.*, 134 F.3d 1090, 1093 (Fed. Cir. 1998) (“[I]n certain limited circumstances, where all substantial rights under the patent have been transferred in the form of an exclusive license, . . . the licensee [is] the virtual assignee.”). Courts have held that “an assignee is the patentee and has standing to bring suit for infringement in its own name.” *Id.*; see also 35 U.S.C. § 100(d) (2006) (defining the term “patentee” as including “not only the patentee to whom the patent was issued but also the successors in title to the patentee”); 35 U.S.C. § 281 (providing that a “patentee” has a “remedy by civil action” for patent infringement); *Arachnid, Inc. v. Merit Indus., Inc.*, 939 F.2d 1574, 1578-79 (Fed. Cir. 1991) (interpreting §§ 281 and 100(d) to require that a party holding legal title to the patent bring an infringement suit to vindicate its rights).

On the other hand, a nonexclusive license is characterized by the patent holder promising only that it will not sue the licensee for infringement, with no other promises regarding how it will exercise its monopoly power.⁸⁰ The nonexclusive licensee “has no property interest in the monopoly of the patent.”⁸¹ Furthermore, unlike an exclusive licensee, the nonexclusive licensee does not have a contract with the patent owner that forbids others from practicing the invention.⁸² “[T]he patent owner may freely license others, or may tolerate infringers,” without violating any rights of the nonexclusive licensee.⁸³ Thus, a nonexclusive patent licensee only has the right to practice the patented invention and does not have the right to sue others for infringing the patent.⁸⁴

D. *Patent Law’s Strong Protection of Owners’ Rights*

As the economic climate shifts from an industrial-based economy to a knowledge-based economy, strong protection of patent rights is used to ensure that knowledge is not exploited.⁸⁵ For example, on the international level, in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), the United States entered into an international agreement known as the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) to establish standards for global patent regulation.⁸⁶ Additionally, as discussed previously, the

⁸⁰ HAROLD EINHORN & THOMAS J. PARKER, 1 PATENT LICENSING TRANSACTIONS § 1.01[2][c] (2007).

⁸¹ *W. Elec. Co. v. Patent Reproducer Corp.*, 42 F.2d 116, 118 (2d Cir. 1930); see also *id.* at 118-19 (discussing the lack of a contract preventing others from practicing the invention).

⁸² See *id.* at 118-19.

⁸³ *Id.* at 118.

⁸⁴ See *id.* (“[A] bare license to practice a patented invention gives the licensee no right to join as plaintiff in a suit against an infringer.”).

⁸⁵ For a discussion of the United States’ shift from an industrial-based economy to a knowledge-based economy and the use of intellectual property as a global currency, see Colleen Spring Zimmerman, *Overview: Intellectual Property—the New Global Currency*, in 1 INTELLECTUAL PROPERTY IN THE GLOBAL MARKETPLACE 0.1-0.40 (Melvin Simensky et al. eds., 2d ed. 1999).

⁸⁶ See JOHN BRAITHWAITE & PETER DRAHOS, GLOBAL BUSINESS REGULATION 56-57, 61-65 (2000) (tracing the evolution of international protections for intellectual property and examining how the United States made maximizing intellectual property privileges the number-one priority of trade policy); William Hennessey, Patent Protection and Its Role in Promoting Invention, Innovation, and Technological Development 3-4, 7-8 (June 1, 1999), <http://www.piercelaw.edu/assets/pdf/hennessey-patentprotection-and-its-role-in-promoting.pdf> (discussing the benefits of stronger patent-protection rights arising out of TRIPS).

Constitution provides that inventors and creators be rewarded with exclusive rights to their creations and discoveries.⁸⁷

In exchange for disclosing the invention, the patent owner is given the exclusive right to the invention.⁸⁸ As part of this right, the patent owner has the choice of granting, to whomever it desires, a full assignment, an exclusive license, or a nonexclusive license for the patented invention.⁸⁹ The type of license granted determines the licensee's rights and scope of use of the patented invention.⁹⁰

In order to exercise her right to the fullest extent, the patent owner must have control over the identity of the patent licensee.⁹¹ This, however, becomes an issue when a Chapter 11 debtor-licensee wishes to assume the patent license during bankruptcy proceedings through the bankruptcy estate, which is considered a separate legal entity from the debtor.⁹² In bankruptcy, when the debtor's estate assumes the license, the debtor-licensee effectively assigns the license to the estate. This automatic assignment, though beneficial to the debtor-licensee, is problematic for the patent licensor because the patent license is no longer held by the same legal entity as it was prebankruptcy.⁹³ Furthermore, even assuming that the patent license was still held by the same prepetition "entity," the same right-to-control problems would arise once the debtor-licensee tried to sell the license to a third party as part of its restructuring or reorganization plan under Chapter 11.

⁸⁷ See U.S. CONST. art. I, § 8, cl. 8.

⁸⁸ See discussion *supra* Section II.A.

⁸⁹ See *Waterman v. Mackenzie*, 138 U.S. 252, 255 (1891) (distinguishing between patent assignments and licenses).

⁹⁰ See, e.g., *Tulip Computers Int'l B.V. v. Dell Computer Corp.*, 262 F. Supp. 2d 358, 364-65 (D. Del. 2003) (holding that the language of the license agreement, which defined the scope of the license, could not be ignored).

⁹¹ See *Gardner v. Nike, Inc.*, 279 F.3d 774, 780-81 (9th Cir. 2002) (explaining the "strong policy reasons [for placing] the burden on the licensee to get the licensor's explicit consent" before transferring a license to a third party); *Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corp.*, 271 F.3d 1081, 1088 (Fed. Cir. 2001) (noting that "[a]llowing free assignability of patent licenses" would result in the patent holder losing "the very important ability to control the identity of the licensees"), *vacated on other grounds en banc*, 284 F.3d 1323 (Fed. Cir. 2002); *Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d 673, 679-80 (9th Cir. 1996) (relying on the policy concern that the patent holder have the ability to control the identity of licensees and holding that nonexclusive patent licenses are not assignable); cf. *Harris v. Emus Records Corp.*, 734 F.2d 1329, 1334 (9th Cir. 1984) (noting in the context of a copyright claim that the requirement that the licensee obtain explicit permission ensures that the licensor will be able to monitor the use of the property right).

⁹² See 11 U.S.C. § 541(a) (2006).

⁹³ See also discussion *supra* note 48 (noting that the question of whether a legal transfer occurs between a debtor and its debtor-in-possession is still open).

III. THE LEGAL SYSTEM'S APPROACH TO THE TENSION BETWEEN BANKRUPTCY AND PATENT LAW

A. *Transferability of Patent Licenses and the Federal Common Law Principle*

As every law student has learned in Civil Procedure, the general rule, as stated in *Erie Railroad Co. v. Tompkins*, is that “[t]here is no federal general common law.”⁹⁴ The courts have allowed federal common law, however, where a federal rule of decision is “necessary to protect uniquely federal interests.”⁹⁵ In such cases, the creation of a federal rule should be “limited to situations where there is a ‘significant conflict between some federal policy or interest and the use of state law.’”⁹⁶ In the special case of patents and patent licensing, the courts have developed a federal common law principle to govern the transferability of patent-license rights.⁹⁷ The default rule is that, unless the patent license expressly authorizes the transfer of the license, a patent licensee’s rights are personal and nontransferable.⁹⁸

⁹⁴ 304 U.S. 64, 78 (1938).

⁹⁵ *Texas Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 640 (1981) (internal quotation marks omitted) (quoting *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 426 (1964)).

⁹⁶ *O’Melveny & Myers v. FDIC*, 512 U.S. 79, 87 (1994) (quoting *Wallis v. Pan Am. Petroleum Corp.*, 384 U.S. 63, 68 (1966)).

⁹⁷ *See Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 150-51 (1989) (acknowledging that, to the extent state intellectual property regulation conflicts with federal regulation, it is preempted because national uniformity in the balance struck by patent protection is of the utmost importance); *Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corp.*, 271 F.3d 1081, 1088-89 (Fed. Cir. 2001) (explaining the development and rationale of the federal common law principle governing patent licensing), *vacated on other grounds en banc*, 284 F.3d 1323 (Fed. Cir. 2002). Note, however, that scholars have debated whether a federal common law really exists. *See, e.g.*, Marie T. Reilly, *The Federal Interest in the Transfer of Patent License Rights in Bankruptcy*, 10 J. BANKR. L. & PRAC. 3, 15-23 (2001) (arguing that the “personal” nature of patent licensing amounts to a state law contract issue and, therefore, cannot amount to a federal common law with respect to patent-license transferability).

⁹⁸ *See Gilson v. Republic of Ireland*, 787 F.2d 655, 658 (D.C. Cir. 1986) (“It is well settled that a non-exclusive licensee of a patent has only a personal and not a property interest in the patent and that this personal right cannot be assigned unless the patent owner authorizes the assignment or the license itself permits assignment.”). Other forms of intellectual property, such as copyright, also follow the same default rule. Under copyright law, “a non-exclusive licensee . . . has only a personal and not a property interest in the [intellectual property],” which “cannot be assigned unless the [intellectual property] owner authorizes the assignment.” *In re Patient Educ. Media, Inc.*, 210 B.R. 237, 242-43 (Bankr. S.D.N.Y. 1997) (internal quotation marks omitted) (quoting *Gilson*, 787 F.2d at 658); *see also* 3 MELVIN B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 10.02[A] (2009) (noting that the grant of a nonexclusive license is not a transfer of ownership).

The federal common law principle of patent nonassignability “has been the rule at least since 1852 when the Supreme Court decided *Troy Iron & Nail v. Corning*.”⁹⁹ Even after the Supreme Court stated in *Erie* that there is no general federal common law, federal courts have continued to apply the default rule of patent nonassignability.¹⁰⁰ As explained by the Seventh Circuit in *Unarco Industries, Inc. v. Kelley Co.*, application of the rule is justified because patent law policy “is so dominated by the sweep of federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than by local law.”¹⁰¹ In addition, the Ninth Circuit’s express acknowledgment that patents are a matter of federal policy justifies the application of federal law.¹⁰²

Many lower federal courts have agreed with the Seventh and Ninth Circuits’ rationales, recognizing that the federal common law prohibits a bankruptcy assignment of a patent license without the consent of the licensor.¹⁰³ Further, these courts have recognized that the federal common law preempts any state law or bankruptcy policy that would permit a bankruptcy assignment despite the licensor’s opposition.¹⁰⁴ Thus, these courts consider the federal common law of nonassignability to be within the scope of “applicable law” under section 365(c)(1)(A) of the Bankruptcy Code.¹⁰⁵ Accordingly, the free trans-

⁹⁹ PPG Indus., Inc. v. Guardian Indus. Corp., 597 F.2d 1090, 1093 (6th Cir. 1979).

¹⁰⁰ See, e.g., Everex Sys., Inc. v. Cadtrak Corp. (*In re CFLC, Inc.*), 89 F.3d 673, 679-80 (9th Cir. 1996) (holding that “[b]ecause federal law governs the assignability of nonexclusive patent licenses, and because federal law makes such licenses personal and assignable only with the consent of the licensor, [a] license is not assumable and assignable in bankruptcy under 11 U.S.C. § 365(c)”).

¹⁰¹ 465 F.2d 1303, 1306 (7th Cir. 1972) (internal quotation marks omitted) (quoting *Sola Elec. Co. v. Jefferson Co.*, 317 U.S. 173, 176 (1942)).

¹⁰² See *In re CFLC*, 89 F.3d at 679 (noting that permitting states to provide for free assignability of nonexclusive patent licenses “would undermine the reward that encourages invention because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of an existing patent license from a licensee” (emphasis omitted)).

¹⁰³ See, e.g., Murray v. Franke-Misal Techs. Group, LLC (*In re Supernatural Foods, LLC*), 268 B.R. 759, 802 (Bankr. M.D. La. 2001) (“The rule, simply stated, is that while ownership of patent rights is assignable, the rights granted under a non-exclusive license cannot inure to a third party, unless the licensor consents to such assignment.”).

¹⁰⁴ *Id.*

¹⁰⁵ See, e.g., *In re CFLC*, 89 F.3d at 680 (concluding that because the federal common law principle of nonassignability governs nonexclusive licenses, it is applicable under section 365 of the Bankruptcy Code); *In re Supernatural Foods*, 268 B.R. at 796 (asserting that section 365(c)(1) of the Bankruptcy Code enforces the common law of nonassignability).

ferability principle codified in section 365(f) is subject to the limitations of the federal common law of nonassignability.¹⁰⁶

Some state courts, however, have rejected the application of such a common law principle.¹⁰⁷ Most notably, in *Farmland Irrigation Co. v. Dopplmaier*, Justice Traynor rejected the notion of a federal common law and held that state law should govern the assignment of patent licenses.¹⁰⁸ Justice Traynor identified three bases for the decision: (1) because the nonassignability doctrine was decided before *Erie*, it did not address the issue of whether state or federal law should apply; (2) the fact patterns in earlier cases had license agreements based on the personal skills of the licensee; and (3) the federal common law rule undermined important state rules that favored free assignability.¹⁰⁹

Many commentators have adopted Justice Traynor's reasoning, noting that neither the Seventh nor the Ninth Circuit ever truly addressed whether there was an underlying conflict between state and federal policy, or whether such a conflict would justify undermining state law.¹¹⁰ Others argue that under a proper economic approach, state law should prevail because it allows "the parties to maximize the value of the licenses to themselves and to society."¹¹¹ In addition, some commentators take the view that "federal courts appear to have overreached themselves in continuing to invent federal common law to forbid the assignment of a license agreement."¹¹²

¹⁰⁶ See 11 U.S.C. § 365(c) (2006) (proscribing assignment when "applicable law" prevents parties other than the debtor from accepting or rendering performance on a contract); *id.* § 365(f) (allowing a trustee to assign a debtor's contracts except as provided in subsection (c)).

¹⁰⁷ See, e.g., *Superbrace, Inc. v. Tidwell*, 21 Cal. Rptr. 3d 404, 414 (Ct. App. 2004) ("[W]e choose to stand steadfastly by our Supreme Court's 1957 ruling in *Dopplmaier* that state law, not federal common law, is to be applied when determining whether a patent license is assignable.").

¹⁰⁸ 308 P.2d 732, 739 (Cal. 1957) (stating that there is "no policy underlying the federal patent statutes that requires a uniform federal rule of construction of license contracts to determine their assignability").

¹⁰⁹ *Id.* at 738-40.

¹¹⁰ See, e.g., Carole A. Quinn & R. Scott Weide, *Violation of the Erie Doctrine: Application of a Rule of Federal Common Law to Issues of Patent License Transferability*, 32 CREIGHTON L. REV. 1121, 1143-45 (1999) (providing hypothetical situations to which application of federal law is unjustified).

¹¹¹ Daniel A. Wilson, *Patent License Assignment: Preemption, Gap Filling, and Default Rules*, 77 B.U. L. REV. 895, 911 (1997).

¹¹² Aaron Xavier Fellmeth, *Control Without Interest: State Law of Assignment, Federal Preemption, and the Intellectual Property License*, 6 VA. J.L. & TECH. 8, ¶ 81 (2001), <http://vjolt.net/vol6/issue1/v6i1a08-Fellmeth.html>.

B. *Inconsistent Case Law*

Despite the debate, one central factor emerges from these competing approaches: the patent holder's consent to transferability. From a bankruptcy perspective, those opposed to the federal common law approach view nonexclusive patent licenses as undermining the fundamental principle of maximizing a debtor's estate.¹¹³ Under this view, requiring a licensor's explicit consent impedes the free transferability of the license, thereby undermining the heart of bankruptcy restructuring.¹¹⁴ From a patent perspective, however, a licensor's control over its competitors is fundamental to a patent owner's right to exclude.¹¹⁵ Thus, in order to prevent injury to the nondebtor party, a patent owner's express authorization should be required before a debtor-licensee may assume and assign its patent license.¹¹⁶

The question then becomes whether a nonexclusive licensee can continue to operate under its license once it files for bankruptcy. Put another way, does the combination of bankruptcy and patent law result in a prohibition against assumption and assignment of patent licenses such that the debtor can no longer use the license?¹¹⁷ Because a nonexclusive patent license does not constitute a sale of the patent and no ownership rights are transferred, the debtor-licensee cannot sell its license agreement in order to pay its creditors in a bankruptcy proceeding.¹¹⁸ Ultimately, reconciling the conflict between patent

¹¹³ See, e.g., Wilson, *supra* note 111, at 910-11 (arguing against federal patent policy preemption of state laws permitting assignment because such preemption prevents the maximization of license values).

¹¹⁴ See *id.* (asserting that license assignment "allow[s] the parties to maximize the value of the licenses to themselves and to society").

¹¹⁵ See *Concrete Washout Sys., Inc. v. Washout Sys., LLC*, No. 08-2214, 2008 WL 5411965, at *3 (E.D. Cal. Dec. 24, 2008) ("One of the fundamental and valuable aspects of a patent is the right to exclude others from using one's invention. In light of Plaintiff's likelihood of success on the merits, its inability to control the use of its invention will constitute irreparable injury." (citation omitted)).

¹¹⁶ See *supra* Sections II.B-D.

¹¹⁷ See 11 U.S.C. § 365(c)(1) (2006) (prohibiting a trustee from assuming or assigning debtor contracts when applicable law excuses a party to the contract, other than the debtor, from accepting or rendering performance); *id.* § 365(f) (allowing assignments except when prohibited by subsection (c)).

¹¹⁸ See *In re Access Beyond Techs., Inc.*, 237 B.R. 32, 44 (Bankr. D. Del. 1999) ("Unless the [license] conveys some or all of the right to exclude others from practicing the invention, it will not convey an interest in the patent, but is a mere license."). An exclusive license will convey an interest in the patent, but a nonexclusive license is still a mere license and is treated as an executory contract subject to the rules of assumption and assignment. See *id.* at 44-45 (holding that the license at issue was non-exclusive and was therefore an executory contract).

rights and bankruptcy principles requires determining whether the licensor must provide express consent to the transferability of the license in order for the debtor, as debtor-in-possession, to assume and assign the license to support its reorganization.¹¹⁹

The case law, however, has not provided a clear answer. *In re Alltech Plastics, Inc.*, decided in 1987, was the earliest bankruptcy court decision to hold that the federal common law principle of nonassignability forecloses the transfer of a patent license.¹²⁰ In *Alltech*, the debtor had acquired a nonexclusive license to manufacture plastic containers using a patented process.¹²¹ Upon filing for bankruptcy, the debtor sought to sell its interest to a third party, but the patent holder contended that under the federal common law such an assignment was prohibited without its express consent.¹²² The patent holder further asserted that the contract was nondelegable and that, therefore, section 365(c) of the Code applied and precluded the debtor from assumption or assignment.¹²³ By contrast, the intended third party transferee took the position that the court should apply the free transferability principle of section 365(f), which meant any antiassignment clause in "applicable law" was unenforceable.¹²⁴ The court ultimately held that, despite the provisions of section 365(f), the federal common law principle of patent nonassignability governed.¹²⁵ The court concluded that,

although [a patent license's] nonassignment is not statutorily mandated, the century old common law classification of patent licenses appears to place them within the realm of the types of contracts traditionally associated with section 365(c). As such . . . the Trustee in this instance does not have the power to assign the patent license absent consent from the licensor.¹²⁶

¹¹⁹ See Kuney, *supra* note 17, at 142 (defining this as the "critical issue" that emerges once a license is found to be an executory contract for purposes of section 365).

¹²⁰ 71 B.R. 686, 690 (Bankr. W.D. Tenn. 1987) ("[N]otwithstanding subsection 365(f), both [federal common] law and equity pursuant to 11 U.S.C. § 365(c) 'excuse' the nondebtor party from accepting assignment . . ."). Although the debtor in *Alltech* filed for Chapter 7, the court's rationale is relevant and applicable to both Chapter 7 and 11 cases.

¹²¹ *Id.* at 687.

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.* at 687-88.

¹²⁵ See *id.* at 689 (noting that "[t]he rights of the patent owner to license the use of his invention is a creature of federal common law as is the right of the licensee to have the license construed").

¹²⁶ *Id.*

After *Alltech*, this question of federal common law applicability in bankruptcy proceedings did not reach the circuit court level for approximately ten years.

Finally in 1996, the Ninth Circuit addressed the issue in *Everex Systems, Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*.¹²⁷ In *In re CFLC*, the debtor was in the business of manufacturing personal computers and had a nonexclusive license to use Cadtrak's computer-graphics technology.¹²⁸ When the debtor sought to sell substantially all of its assets, Cadtrak objected to the sale on the basis that the patent license was not assignable under federal common law.¹²⁹ The Ninth Circuit, while recognizing that "[t]here is no federal general common law,"¹³⁰ was concerned that the "free assignability" notion of state law would undermine the monopoly rights fundamental to federal patent policy and hinder the critically important economic incentive that encourages innovation.¹³¹ The court ultimately held that the federal common law principle of nonassignability applied, and the debtor was barred from assigning the license without Cadtrak's consent.¹³²

Since *Alltech* and *In re CFLC*, two competing judicial approaches have developed at the circuit court level: the "hypothetical" test and the "actual" test. The hypothetical test, which requires the licensor's explicit consent for assignment, has been adopted by four circuits—the Third, Fourth, Ninth, and Eleventh—and is frequently applied in cases involving technology companies.¹³³ Most bankruptcy courts, however, do not follow the hypothetical test.¹³⁴ Instead, they, along

¹²⁷ 89 F.3d 673 (9th Cir. 1996).

¹²⁸ *Id.* at 674-75.

¹²⁹ *Id.* at 675.

¹³⁰ *Id.* at 678 (alteration in original) (quoting *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938)).

¹³¹ *See id.* at 679 ("In essence, every licensee would become a potential competitor with the licensor-patent holder in the market for licenses under the patents.").

¹³² *Id.* at 679-80.

¹³³ *See, e.g.*, *RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp.)*, 361 F.3d 257, 271 (4th Cir. 2004) ("Without [the patent holder's] consent, [the debtor] was precluded from assuming the agreement."); *Perlman v. Catapult Entm't, Inc. (In re Catapult Entm't, Inc.)*, 165 F.3d 747, 750 (9th Cir. 1999) ("[W]e are bound by the plain terms of the statute and . . . adopt[] the 'hypothetical test.'"); *City of Jamestown, Tenn. v. James Cable Partners, L.P. (In re James Cable Partners, L.P.)*, 27 F.3d 534, 537 (11th Cir. 1994) ("The first condition [of 11 U.S.C. § 365(c)(1)] presents a hypothetical question . . ."); *In re W. Elecs. Inc.*, 852 F.2d 79, 83 (3d Cir. 1988) (holding that the language of section 356(c)(1) supports the use of the hypothetical test).

¹³⁴ *See, e.g.*, *United States v. TechDyn Sys. Corp. (In re TechDyn Sys. Corp.)*, 235 B.R. 857, 861 (Bankr. E.D. Va. 1999) (applying the hypothetical test but noting that "[the actual] test . . . has been adopted by a clear majority of the lower courts").

with the First Circuit, have adopted the actual test, which does not require explicit consent.¹³⁵

1. Development and Adoption of the Hypothetical Test

The hypothetical test was first introduced in *In re West Electronics Inc.*¹³⁶ *West* was not a patent-licensing case; instead, the case involved an executory contract for missile-launcher power-supply units between a defense contractor and the United States.¹³⁷ *West*, the supplier, suffered from operational problems, late deliveries, and irregularities in its accounting procedures.¹³⁸ Upon investigation, the United States sought to terminate the contract *prior* to *West*'s bankruptcy filing, a fact suggesting that there was a material problem with *West*'s ability to perform.¹³⁹ When *West* filed its bankruptcy petition and received an automatic stay, the government sought an order to lift the stay so it could terminate the contract agreement.¹⁴⁰ *West* contended that "it had the capacity and intention to cure the default" and should be given the opportunity to perform.¹⁴¹ Both the bankruptcy court and the district court on review denied the government's motion, finding that the agreement constituted an executory contract.¹⁴²

The issue facing the Third Circuit was whether the debtor could assume the executory contract even if it had no intention of assigning it to a third party.¹⁴³ The court answered in the negative.¹⁴⁴ The tension was between 41 U.S.C. § 15, which prevents transfers of government contracts to third parties, and section 365(f) of the Bankruptcy Code, which provides that executory contracts are generally freely transferable.¹⁴⁵ The Third Circuit reversed the lower courts, holding that the government contract could not be assumed because "*West* could not force the government to accept the 'personal attention and

¹³⁵ See *Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489, 493 (1st Cir. 1997) (declining to follow the hypothetical test); *Summit Inv. & Dev. Corp. v. Leroux*, 69 F.3d 608, 612 (1st Cir. 1995) (same).

¹³⁶ 852 F.2d at 83.

¹³⁷ *Id.* at 80.

¹³⁸ *Id.*

¹³⁹ *Id.*

¹⁴⁰ *Id.* at 80-81.

¹⁴¹ *Id.*

¹⁴² *Id.* at 81.

¹⁴³ *Id.* at 82-83.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

services' of a third party without [the government's] consent."¹⁴⁶ West was barred from assuming and assigning the contract.¹⁴⁷ In reaching its conclusion, the court examined the plain meaning of the statute and stated that

11 U.S.C. § 365(c)(1) creates a hypothetical test—*i.e.*, under the applicable law, could the government refuse performance from “an entity *other* than the debtor or the debtor in possession.” . . . [T]he relevant inquiry is not whether 41 U.S.C. § 15 would preclude an assignment from West as a debtor to West as a debtor in possession, but whether it would foreclose an assignment by West to another defense contractor.¹⁴⁸

Although *West* did not involve a patent license, it developed the hypothetical test that was later used by the Eleventh Circuit in a case relating to a franchise agreement.¹⁴⁹ It was not until 1999 that the hypothetical test was applied in the context of patent licensing.

In *In re Catapult Entertainment, Inc.*, the Ninth Circuit expressly adopted the hypothetical test, holding that the “applicable law,” as relating to section 365(c)(1) of the Bankruptcy Code, was the federal common law principle of patent nonassignability.¹⁵⁰ Catapult Entertainment was in the business of creating an online gaming network for 16-bit console videogames.¹⁵¹ Catapult also entered into two nonexclusive license agreements with Stephen Perlman for the use of his patents and patent applications.¹⁵² When Catapult filed for reorganization under Chapter 11, it proposed a reorganization plan involving a reverse triangular merger with two other companies in which Catapult would emerge as the surviving corporation.¹⁵³ The reorganization plan also proposed that after the merger, Catapult would assume the patent licenses in order to continue operations.¹⁵⁴ Catapult's creditors and equity holders voted in favor of the reorganization plan and the

¹⁴⁶ *Id.* at 83.

¹⁴⁷ *Id.*

¹⁴⁸ *Id.* The court also held that, based upon the literal meaning of the statute and Congress's intent, West as a debtor and West as a debtor-in-possession were “materially distinct entities.” *Id.*

¹⁴⁹ *City of Jamestown, Tenn. v. James Cable Partners, L.P.* (*In re James Cable Partners, L.P.*), 27 F.3d 534, 537 & n.6 (11th Cir. 1994).

¹⁵⁰ *Perlman v. Catapult Entm't, Inc.* (*In re Catapult Entm't, Inc.*), 165 F.3d 747, 750 (9th Cir. 1999).

¹⁵¹ *Id.* at 748.

¹⁵² *Id.*

¹⁵³ *Id.* at 748-49.

¹⁵⁴ *Id.* at 749.

bankruptcy court confirmed it.¹⁵⁵ Perlman, however, objected to the plan and appealed.¹⁵⁶

On appeal, the Ninth Circuit reversed the confirmation of Catapult's reorganization plan.¹⁵⁷ In doing so, the Ninth Circuit became the first circuit court to hold that a nonexclusive patent license could not be assumed in a bankruptcy proceeding without the consent of the licensor.¹⁵⁸ Similar to *West*, the issue facing the Ninth Circuit was whether Catapult, as the debtor-in-possession, could assume the Perlman licenses without Perlman's consent.¹⁵⁹ The court, noting the tension between the hypothetical and actual test, adopted and explained the hypothetical test:

The literal language of § 365(c)(1) is thus said to establish a "hypothetical test": a debtor in possession may not assume an executory contract over the nondebtor's objection if applicable law would bar assignment to a hypothetical third party, even where the debtor in possession has no intention of assigning the contract in question to any such third party.¹⁶⁰

Under the hypothetical test, the court ruled that Catapult could not assume the Perlman licenses if "(A) federal patent law excuses Perlman from accepting performance from or rendering performance to an entity other than Catapult . . . ; and (B) Perlman does not consent to such assumption."¹⁶¹ Thus, if a debtor cannot assume a license, this is equivalent to a rejection and the license effectively terminates as a matter of law upon bankruptcy, unless the licensor agrees otherwise.¹⁶²

Most recently, the Fourth Circuit adopted the hypothetical test in *RCI Technology Corp. v. Sunterra Corp. (In re Sunterra Corp.)*.¹⁶³ There, Sunterra, the debtor, had entered into a software license agreement with RCI in which RCI granted Sunterra a nonexclusive license for the

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* at 748.

¹⁵⁸ *See id.* at 754-55 (holding that "where applicable nonbankruptcy law makes an executory contract nonassignable because the identity of the nondebtor party is material, a debtor in possession may not assume the contract absent consent of the nondebtor party").

¹⁵⁹ *Id.* at 749. Although Perlman also contended that section 365(c)(1) prohibited the *assignment* of its licenses to the third parties involved in the reverse triangular merger, the court did not reach the issue of assignment because it barred Catapult from even assuming the Perlman licenses. *Id.* at 749 n.1.

¹⁶⁰ *Id.* at 750.

¹⁶¹ *Id.* at 750-51 (italics omitted).

¹⁶² *See id.*

¹⁶³ 361 F.3d 257 (4th Cir. 2004).

use of its software.¹⁶⁴ Sunterra filed for bankruptcy and, prior to the court's approval of the reorganization plan, RCI filed a motion to have the software license deemed rejected. RCI asserted that the license was an executory contract and that Sunterra, as debtor-in-possession, was precluded by section 365(c) from assuming the license without RCI's consent.¹⁶⁵ RCI further contended that because it had not given Sunterra permission to assume the license, the court was required, as a matter of law, to deem the license rejected.¹⁶⁶ The bankruptcy court, adopting the actual test,¹⁶⁷ held that section 365(c) did not prohibit Sunterra, as debtor-in-possession, from assuming the license because Sunterra never intended to assign the license to a third party.¹⁶⁸ Under this interpretation, "Sunterra, as debtor in possession, was entitled to assume the [license] because it did not intend to assign, and RCI would not *actually* be forced to accept performance from a party other than Sunterra."¹⁶⁹ On review, the district court affirmed the bankruptcy court, ruling that because RCI would not be asked to accept performance from a party other than Sunterra, Sunterra was not precluded from assuming the patent license under section 365(c).¹⁷⁰

On appeal, the Fourth Circuit rejected the lower courts' adoption of the actual test and adopted the hypothetical test.¹⁷¹ The court, in rejecting the actual test, refused to interpret the "or" in the statutory phrase "assume or assign" as a conjunctive "and."¹⁷² In addition, the court held that federal copyright law was the "applicable nonbankruptcy law," and thus Sunterra was precluded from assuming the nonexclusive license because the federal common law prohibited assignment.¹⁷³

¹⁶⁴ *Id.* at 260. Although *In re Sunterra* dealt with software licensing rather than patent licensing, the same federal principle of common law patent nonassignability applies to copyright law, because copyrights—like patents—are a form of intellectual property governed by federal statute. See Menell, *supra* note 27, at 800-02 (discussing bankruptcy's treatment of copyright licenses and the relationship between copyright and patent law); *supra* note 98 and accompanying text.

¹⁶⁵ *In re Sunterra Corp.*, 361 F.3d at 261.

¹⁶⁶ *Id.*

¹⁶⁷ The bankruptcy court adopted the actual test, see *infra* subsection III.B.2, which reads the disjunctive "or" in section 365(c) as a conjunctive "and." *Id.* at 263.

¹⁶⁸ *Id.* at 262-63.

¹⁶⁹ *Id.* at 263.

¹⁷⁰ *Id.*

¹⁷¹ *Id.* at 267.

¹⁷² *Id.*

¹⁷³ See *id.* at 262 n.7, 271.

2. Development and Adoption of the Actual Test

Although several circuits have adopted the hypothetical test, most bankruptcy courts, as well as the First Circuit, have expressly rejected it in favor of the actual test.¹⁷⁴ Under the actual test, section 365(c) is read in reference to the “actual” intent of the debtor with respect to assigning the license.¹⁷⁵ If the debtor has no intent to assign the license, then section 365(c) does not prevent assumption of the license.¹⁷⁶ Under the actual test, the debtor does not need the licensor’s consent in order to assume the license.¹⁷⁷

The actual test was first developed by the First Circuit in *Summit Investment & Development Corp. v. Leroux*.¹⁷⁸ In *Leroux*, the court looked to the legislative history of the Bankruptcy Code and concluded that Congress intended section 365(c) to provide the nondebtor party with the benefit of its bargain.¹⁷⁹ Relying on the 1984 Amendments to the Bankruptcy Code, the court noted that the change in statutory language from “debtor” to “the debtor or the debtor in possession” indicated Congress’s intent that the prohibition on assumption does not apply when the debtor-in-possession is the party who will be performing the debtor’s duties and accepting performance from the nondebtor party.¹⁸⁰ The court noted that this type of analysis results in a “case-by-case inquiry into the actual consequences . . . to the nondebtor party,” instead of the abstract rule of the hypothetical test.¹⁸¹ The court further stated that in order to prevent assumption of the contract, the nondebtor party “must make an individualized showing that it would not receive the ‘full benefit of [its] bargain’ were an entity to be substituted for the debtor from whom performance is due.”¹⁸²

Although *Leroux* was not a patent-licensing case, it was not long before the First Circuit applied the actual test in the context of patent

¹⁷⁴ See *Summit Inv. & Dev. Corp. v. Leroux*, 69 F.3d 608, 612-14 (1st Cir. 1995) (developing the actual test); see also *Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489, 493 (1st Cir. 1997) (applying the actual test); cf. *United States v. TechDyn Sys. Corp. (In re TechDyn Sys. Corp.)*, 235 B.R. 857, 860-61 (Bankr. E.D. Va. 1999) (adopting the hypothetical test but noting that “[the actual] test . . . has been adopted by a clear majority of lower courts”).

¹⁷⁵ *Leroux*, 69 F.3d at 612.

¹⁷⁶ *Id.*

¹⁷⁷ See *id.*

¹⁷⁸ See *id.* at 612-14.

¹⁷⁹ *Id.* at 612-13.

¹⁸⁰ *Id.* at 613 (citing H.R. REP. NO. 96-1195, at 12 (1980)).

¹⁸¹ *Id.*

¹⁸² *Id.* (alteration in original).

rights. In *Institut Pasteur v. Cambridge Biotech Corp.*, Cambridge Biotech Corporation (CBC) entered into a mutual cross-license agreement with Institut Pasteur.¹⁸³ In the agreement, CBC was authorized to utilize Pasteur's HIV diagnostic procedures in any diagnostic kits CBC sold in the United States and other countries.¹⁸⁴ When CBC filed for Chapter 11, its reorganization plan proposed that it assume the license and continue to operate its diagnostics division using Pasteur's patented procedures.¹⁸⁵ CBC's reorganization plan also called for the sale of CBC's stock to a subsidiary of bioMerieux, one of Pasteur's direct competitors.¹⁸⁶ Naturally, Pasteur objected to CBC's reorganization plan, contending that the proposed sale of CBC's stock to bioMerieux amounted to CBC's assumption of the cross-licenses and their de facto assignment to a third party (here, bioMerieux).¹⁸⁷ Of particular note, Pasteur's licensing director "attested that Pasteur would not have granted its competitor, bioMerieux, or a subsidiary, a patent license under the terms allowed CBC."¹⁸⁸

Although it conceded that Pasteur's position was understandable, the First Circuit, following its precedent in *Leroux*, rejected the hypothetical test and instead ruled that there needed to be a case-by-case inquiry into whether the nondebtor party (i.e., Pasteur) was actually being forced to accept performance from someone (i.e., bioMerieux) other than the party with whom it had originally contracted (i.e., CBC).¹⁸⁹ In this context, the First Circuit held that "the bankruptcy court cannot simply presume as a matter of law that the debtor-in-possession is a legal entity *materially* distinct from the prepetition debtor with whom the nondebtor party . . . contracted."¹⁹⁰ Rather, the focus should be "on the performance actually to be rendered by the debtor-in-possession," and whether Pasteur would be denied the full benefit of its bargain.¹⁹¹

Surprisingly, the First Circuit also permitted CBC's stock sale to bioMerieux.¹⁹² In fact, the court held that the stock sale did not result

¹⁸³ 104 F.3d 489 (1st Cir. 1997).

¹⁸⁴ *Id.* at 490.

¹⁸⁵ *Id.*

¹⁸⁶ *Id.*

¹⁸⁷ *Id.* at 490-91.

¹⁸⁸ *Id.* at 491.

¹⁸⁹ *Id.* at 493.

¹⁹⁰ *Id.*

¹⁹¹ *Id.* (citing S. REP. NO. 95-989, at 59 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5845).

¹⁹² *Id.* at 494-95.

in a “different entity” than that with which Pasteur had originally contracted, even though CBC was technically now owned by bioMerieux.¹⁹³ Instead, the court held that because the cross-licenses contained no provision either limiting or terminating CBC’s rights if its stock changed hands, there was no change in beneficial ownership in Pasteur’s license agreement. Under this interpretation, Pasteur could not restrict the license.¹⁹⁴

The Fifth Circuit, in *Bonneville Power Administration v. Mirant Corp.* (*In re Mirant Corp.*), also adopted the actual test but provided a different justification than the First Circuit.¹⁹⁵ Mirant, an electrical power producer and seller, entered into a contract with Bonneville Power Administration (BPA), a federal power-marketing agency within the United States Department of Energy.¹⁹⁶ When Mirant filed for bankruptcy, BPA sought to terminate the contract for future power purchases, asserting the right to do so under an ipso facto default provision that authorized BPA to terminate the contract upon Mirant’s bankruptcy filing.¹⁹⁷ Mirant and BPA agreed that ipso facto clauses were generally invalid under section 365(e).¹⁹⁸ However, they disputed whether ipso facto default provisions remained enforceable under section 365(c) if the contract excused the nondebtor party from accepting performance from a trustee or assignee.¹⁹⁹

Although *Mirant* was not about a patent license, the court noted that the dispute involved essentially the same issue the apparent conflict between subsections 365(c) and 365(f) raises—namely whether a prohibition on assignment applies in cases where no assignment is actually sought.²⁰⁰ The Fifth Circuit held that the “plain text” of section 365(e)(2) requires the use of the actual test because the prohibition

¹⁹³ See *id.*

¹⁹⁴ *Id.*

¹⁹⁵ 440 F.3d 238 (5th Cir. 2006).

¹⁹⁶ *Id.* at 241.

¹⁹⁷ *Id.* at 242-43. Termination upon bankruptcy provisions are often known as ipso facto clauses (the Latin phrase meaning “by the fact itself”) because the language provides that the fact of bankruptcy itself is enough to trigger the termination of the agreement. Generally, ipso facto clauses are unenforceable in bankruptcy under sections 541(c) and 365(e)(1). See THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 40-43 (1986) (justifying bankruptcy law’s disregard of ipso facto clauses); Yeon-Koo Che & Alan Schwartz, *Section 365, Mandatory Bankruptcy Rules and Inefficient Continuance*, 15 J.L. ECON. & ORG. 441, 441-46 (1999) (discussing ipso facto clauses under section 365(e)).

¹⁹⁸ 440 F.3d at 245.

¹⁹⁹ *Id.* at 245-46.

²⁰⁰ *Id.* at 246.

on assignment is “tethered . . . to ‘applicable’ law” and the “applicable law *must apply to a set of circumstances*.”²⁰¹ The court held that “[t]he applicability of the law under § 365(e)(2)(A) is determined not in the abstract but on the record at hand.”²⁰² Furthermore, the court criticized the hypothetical test as being too abstract and complained that it could force courts to decide whether an assignment would be permitted, even given circumstances not actually before the court.²⁰³ The Fifth Circuit was likely concerned with the prospect of rendering an advisory opinion were it forced to rule on an assignment under a host of fact patterns not actually presented.

C. *Recent Case Law Trends in Interpretation*

Although the hypothetical test is currently favored, since *In re Catapult* and *Pasteur* were decided there has been a trend toward a “plain meaning” interpretation of section 365(c). The leading case in this line of reasoning is *In re Footstar, Inc.*²⁰⁴ Footstar, the debtor, had entered into a series of agreements with Kmart that provided for Kmart to operate a separate “Shoemart Corporation” owned 51% by Footstar and 49% by Kmart.²⁰⁵ The agreements also gave Shoemart Corporation the exclusive right to operate footwear departments in particular Kmart stores.²⁰⁶ In addition, the agreements expressly prohibited assignment of the contract.²⁰⁷ Thus, when Footstar filed for bankruptcy and sought to assume the agreements, Kmart asserted that assumption was prohibited.²⁰⁸

In *Footstar*, Judge Hardin addressed the conflict between the actual and hypothetical tests and ultimately concluded that the actual test is more appropriate.²⁰⁹ In his analysis, however, Judge Hardin held that neither the hypothetical nor the actual test applied. Instead, he focused on the “plain meaning” of the statute “to reach a conclusion which is entirely harmonious with both the objective sought to be obtained in Section 365(c)(1) and the overall objectives of the Bank-

²⁰¹ *Id.* at 249-50 (emphasis added).

²⁰² *Id.* at 250.

²⁰³ *See id.*

²⁰⁴ 323 B.R. 566 (Bankr. S.D.N.Y. 2005).

²⁰⁵ *Id.* at 568.

²⁰⁶ *Id.*

²⁰⁷ *Id.* at 569 n.1.

²⁰⁸ *Id.* at 567.

²⁰⁹ *Id.* at 570-71.

ruptcy Code, without construing ‘or’ to mean ‘and.’”²¹⁰ In particular, he held that the previous decisions were fundamentally flawed because they were based on the premise that the term “trustee” was synonymous with “debtor” or “debtor in possession.”²¹¹ He continued by stating that neither the Bankruptcy Code nor its legislative history equates a “trustee” with a “debtor” or “debtor in possession.”²¹² As a result, when the Code refers to both a “trustee” and a “debtor” or “debtor in possession,” the two terms must have different meanings.²¹³ Accordingly, section 365(c) need not restrict assumption of the contract by the debtor-in-possession because it only refers to limitations on the trustee’s ability to assume or assign the contract.²¹⁴ Under this interpretation, the rights of the nondebtor party remain protected because the nondebtor party may decline performance from a party other than the debtor-in-possession.²¹⁵ Furthermore, the debtor party is protected by avoiding “the perverse and anomalous consequence of the ‘hypothetical test’ rule under which a debtor may lose the benefit of a non-assignable contract vital to its economic future solely because it filed for bankruptcy.”²¹⁶

Bankruptcy courts have recently adopted the rationale set forth in *Footstar*.²¹⁷ In *In re Adelpia Communications Corp.*, Judge Gerber rejected the hypothetical test, concluding that the “the right to object to assignment does not by itself affect the right to assume.”²¹⁸ Furthermore, he held that no purpose was served by disqualifying a debtor-in-possession from assuming an executory contract because “[w]hen a debtor in possession, as contrasted to a trustee, wishes to assume, the

²¹⁰ *Id.* at 570.

²¹¹ *See id.* at 570-71 (“To construe ‘trustee’ in Section 365(c)(1) to mean ‘debtors’ or ‘debtors in possession’ would defy the ‘plain meaning’ of the statute as written by Congress and could be characterized as the same sort of judicial legislation as Kmart condemns in the cases that apply the ‘actual test’ to construe ‘or’ as ‘and.’”).

²¹² *Id.* at 571.

²¹³ *Id.*; *see also* 11 U.S.C. § 365(c)(1), (e)(1)–(2), (f) (2006) (identifying distinct roles for debtors and trustees).

²¹⁴ *See In re Footstar*, 323 B.R. at 573-74 (“The basic objective of Section 365(c)(1)—to protect the contract counterparty from unlawful assignment of the contract—simply is not implicated when a debtor in possession itself seeks to assume, but not assign, the contract.”).

²¹⁵ *Id.* at 573.

²¹⁶ *Id.* at 574.

²¹⁷ *See, e.g., In re Adelpia Commc’ns Corp.*, 359 B.R. 65, 72 (Bankr. S.D.N.Y. 2007) (distinguishing between the assumption of a contract and the assignment of a contract).

²¹⁸ *Id.*

underlying needs and concerns to be protected have nothing to do with each other.”²¹⁹

The Bankruptcy Court for the District of New Mexico recently applied the *Footstar* analysis in a patent-licensing case.²²⁰ Aerobox, the debtor, entered into a nonexclusive license for the use of Tubus Bauer’s patent rights and confidential information in manufacturing thermoplastic sandwich panels.²²¹ The license agreement contained an ipso facto clause terminating the agreement if Aerobox became insolvent or went into bankruptcy.²²² Upon Aerobox’s bankruptcy filing, Tubus Bauer filed a motion seeking rejection of the license, asserting that the license could not be assumed or assigned under the hypothetical test.²²³

The court, accepting the logic of *Footstar*, agreed that it “makes no sense to read ‘trustee’ to mean ‘debtor in possession’” because “[d]oing so would ‘render the provision a virtual oxymoron.’”²²⁴ It also held that the limitations of section 365(c)(1) are directed at protecting the nondebtor party from being forced to accept performance from an entity other than the party with whom it originally contracted.²²⁵ Furthermore, the court agreed with the *Institut Pasteur v. Cambridge Biotech Corp.*²²⁶ decision that a debtor-in-possession “is not materially distinct from the pre-bankruptcy entity that is a party to the [license].”²²⁷ On these grounds, the court denied Tubus Bauer’s motion to compel rejection.²²⁸

Interestingly, the court acknowledged the license agreement’s provision requiring the licensor “not to unreasonably withhold its consent to assignment.”²²⁹ Although the creditors’ committee argued that this provision was less restrictive than the general federal common law and constituted either a form of “preconsent” to assumption or an indication that the licensor had “opted out of generally applicable law,” the court ultimately declined to address this point.²³⁰

²¹⁹ *Id.* at 72 n.18.

²²⁰ *In re Aerobox Composite Structures, LLC*, 373 B.R. 135 (Bankr. D.N.M. 2007).

²²¹ *Id.* at 137.

²²² *Id.* at 138.

²²³ *Id.*

²²⁴ *Id.* at 142 (quoting *In re Footstar, Inc.*, 323 B.R. 566, 573 (Bankr. S.D.N.Y. 2005)).

²²⁵ *Id.* at 141.

²²⁶ 104 F.3d 489 (1st Cir. 1997).

²²⁷ *In re Aerobox*, 373 B.R. at 141.

²²⁸ *Id.* at 142.

²²⁹ *Id.*; see also *id.* at 137 n.1 (providing the relevant provision of the license agreement).

²³⁰ *Id.* at 142.

Despite *In re Adelphia* and *In re Aerobox*, not all bankruptcy courts have followed *Footstar*. Most notably, the Bankruptcy Court for the Western District of Pennsylvania rejected the *Footstar* analysis in *Federal Insurance Co. v. Continental Casualty Co.*²³¹ Here, the court, noting that the Western District of Pennsylvania's bankruptcy courts have always employed a broad interpretation of *In re West Electronics*,²³² concluded that the debtor-in-possession was "a distinct entity from the prepetition debtor."²³³ The court, however, also went on to discuss the uncertainty surrounding the treatment of the debtor and the debtor-in-possession as distinct legal entities.²³⁴

IV. INTERPRETING SECTION 365(C): IS THE "OR" REALLY AN "AND"?

A. *The "or" as a Disjunctive "or"*

The plain-meaning rule of statutory interpretation requires that when the statutory language "is plain and admits of no more than one meaning," the court should not try to "interpret" the statute.²³⁵ The language of section 365(c) reads, in part, that "[t]he trustee may not assume *or* assign any executory contract . . . of the debtor."²³⁶ Although the statute clearly says "assume *or* assign," the dispute between the hypothetical and actual tests centers on whether the "or" in the phrase should be read as a disjunctive "or" or as a conjunctive "and."²³⁷

Proponents of the hypothetical test argue that the test is premised on a literal interpretation of the statute—namely, reading the "or" as a disjunctive "or."²³⁸ Reading the "or" literally, section 365(c) states that

²³¹ No. 05-0305, 2006 WL 3386625 (Bankr. W.D. Pa. Nov. 22, 2006).

²³² 852 F.2d 79 (3d Cir. 1988).

²³³ *Cont'l Cas.*, 2006 WL 3386625, at *15.

²³⁴ *Id.*; see also *Biltmore Assoc., L.L.C. v. Twin City Fire Ins. Co.*, No. 05-4220, 2006 U.S. Dist. LEXIS 56034, at *13 n.4 (Bankr. D. Ariz. July 21, 2006) ("The distinction between a debtor and a debtor in possession is nuanced and unclear, and has yielded varying results in district courts, among the circuits, and within the Ninth Circuit."). *But see* 11 U.S.C. § 541(a) (2006) (recognizing that upon filing for bankruptcy, an estate is created with a different legal character than that of the prepetition debtor).

²³⁵ *Caminetti v. United States*, 242 U.S. 470, 485 (1917); see also *Hillman v. IRS*, 263 F.3d 338, 342 (4th Cir. 2001) ("[U]nless there is some ambiguity in the language of a statute, a court's analysis must end with the statute's plain language . . .").

²³⁶ 11 U.S.C. § 365(c) (emphasis added).

²³⁷ See *RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp.)*, 361 F.3d 257, 262 nn.8-9 (4th Cir. 2004) (explaining the difference between the hypothetical and actual tests).

²³⁸ See *id.* at 262 n.8 (stating that the test construes the "or" "to mean what it says"); *City of Jamestown, Tenn. v. James Cable Partners, L.P. (In re James Cable Partners,*

the bankruptcy trustee or debtor-in-possession²³⁹ can neither assume nor assign an executory contract if “applicable law excuses a party, other than the debtor, . . . from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession . . . [and] such party does not consent to such assumption or assignment.”²⁴⁰ Therefore, under this interpretation, the act of assuming an executory contract is an event *separate and distinct* from assigning the executory contract. It follows that the conditions of section 365(c)(1) must apply equally to both the assumption and assignment prongs.²⁴¹ Accordingly, a debtor must reject the contract if applicable law forbids the debtor from assuming *or* assigning the contract.²⁴²

Applying the conditions of section 365(c)(1) to the assumption prong of section 365(c), the statute would read, “The trustee may not assume . . . any executory contract or unexpired lease of the debtor . . . if applicable law excuses a party . . . from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession.”²⁴³

In the context of patent licensing, the applicable law is the federal common law principle of patent nonassignability, which forbids the debtor from transferring the license without the licensor’s explicit

L.P.), 27 F.3d 534, 537 (11th Cir. 1994) (interpreting the statute as requiring the court to answer a “hypothetical question”); *In re W. Elecs. Inc.*, 852 F.2d 79, 83 (3d Cir. 1988) (“11 U.S.C. § 361(c)(1) creates a hypothetical test—*i.e.*, under the applicable law, could the government refuse performance from an entity *other* than the debtor or the debtor in possession.”); *In re Access Beyond Techs., Inc.*, 237 B.R. 32, 48-49 (Bankr. D. Del. 1999) (following the Third Circuit’s adoption of the hypothetical test). Critics of the hypothetical test/literal-meaning reading concede that section 365(c) is written in the disjunctive and, therefore, by its plain language, would prohibit a debtor from “assuming *or* assigning.” *In re Sunterra*, 361 F.3d at 265. They contend, however, that the plain-meaning rule does not apply to section 365(c) because it would create inconsistencies within the Code. See discussion *infra* subsection IV.B.1.

²³⁹ As noted before, the term “trustee” as used in the statute includes a Chapter 11 debtor-in-possession. *In re Sunterra*, 361 F.3d at 261 n.5; *Perlman v. Catapult Entm’t, Inc.* (*In re Catapult Entm’t, Inc.*), 165 F.3d 747, 750 (9th Cir. 1999); see also discussion *supra* note 42 (discussing the powers and rights of a bankruptcy trustee and a debtor-in-possession).

²⁴⁰ 11 U.S.C. § 365(c)(1). Although section 365(c) provides three different conditions under which a trustee may not assume or assign an executory contract, this Comment is only concerned with the first condition, as it is the only condition relevant to patent licensing.

²⁴¹ See *id.* § 365(c)(1)(A); 1 DAVID G. EPSTEIN ET AL., BANKRUPTCY § 5-15, at 474 (1992) (noting that the plain language of section 365(c)(1) “link[s] nonassignability under ‘applicable law’ together with a prohibition on assumption in bankruptcy”).

²⁴² See 11 U.S.C. § 365(c); *In re Sunterra*, 361 F.3d at 269 (holding that construing section 365(c) to mean “assumption *and* assignment” would intrude on legislative function).

²⁴³ *Id.* § 365(c)(1)(A).

consent.²⁴⁴ As courts have held, in order for a patent owner to exercise its right to exclude to the fullest extent, the patent owner must be able to control the identity of its licensees.²⁴⁵ Because a patent license is merely a covenant not to sue for infringement, the patent owner cannot be forced to accept performance of the license from any party other than the one with whom it originally contracted.²⁴⁶ If the patent owner were forced to accept performance from a different party, then the owner would effectively lose control of its monopolistic right to exclude others from practicing the patented invention.²⁴⁷ Forcing the patent owner to accept performance from a third party would result in the patent owner forgoing its right to sue the third party for patent infringement.²⁴⁸ Thus, because the “applicable law” of patent nonassignability prevents the patent owner from having to accept performance from a third-party entity (i.e., a party other than the debtor or debtor-in-possession), the debtor (i.e., the bankruptcy trustee or debtor-in-possession) cannot assume the patent license.

A patent owner is not required to accept performance of the license from an entity other than the entity with which it originally contracted.²⁴⁹ In fact, because the debtor-in-possession is a separate legal entity from the original debtor, the patent owner can only accept performance from the postpetition debtor-in-possession if there is an implicit assumption and assignment of the license from the original deb-

²⁴⁴ See *Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corp.*, 271 F.3d 1081, 1088-89 (Fed. Cir. 2001) (discussing the principle of nontransferability of patents found in federal common law), *vacated on other grounds en banc*, 284 F.3d 1323 (Fed. Cir. 2002); cf. *In re W. Elecs. Inc.*, 852 F.2d 79, 83 (3d Cir. 1988) (describing the nontransferability of government contracts).

²⁴⁵ See *supra* note 91 and accompanying text.

²⁴⁶ See *Rhone-Poulenc Agro*, 271 F.3d at 1088 (noting that allowing free assignability of patent licenses would result in the patent holder losing “the very important ability to control the identity of the licensees”); *Everex Sys., Inc. v. Cadtrack Corp.* (*In re CFLC, Inc.*), 89 F.3d 673, 679 (9th Cir. 1996) (relying on the federal patent policy concern that the patent holder have the ability to control the identity of licensees and holding that nonexclusive patent licenses are not assignable).

²⁴⁷ See *Rhone-Poulenc Agro*, 271 F.3d at 1088 (noting that permitting free assignability would mean “every licensee would become a potential competitor with the licensorpate holder in the market for the invention; and even if the patentee could control the number of licenses, he would lose the very important ability to control the identity of the licensees”).

²⁴⁸ See 35 U.S.C. § 271(a) (2006) (stating that a party that “makes, uses, offers to sell, or sells any patented invention” without authority infringes the patent).

²⁴⁹ See *Rhone-Poulenc Agro*, 271 F.3d at 1088 (“[P]atent licenses are . . . non-transferable in the absence of an agreement authorizing assignment”); *In re CFLC*, 89 F.3d at 679 (stating that a nonexclusive patent license cannot be assigned without the authorization of the patent owner).

tor to the debtor-in-possession.²⁵⁰ If section 365(c)(1)(A) did not contain the language “debtor or debtor in possession,” it is likely that the federal common law principle of patent nonassignability would also forbid assumption of the license on the ground that the debtor is no longer the same legal entity as it was before it entered into bankruptcy.²⁵¹

Having established that section 365(c) prevents assumption of the patent license, I turn to whether assignment of the license would be permitted.²⁵² Applying the conditions of subsection (1) to the assignment prong, section 365(c)(1)(A) reads, “The trustee may not . . . assign . . . any executory contract or unexpired lease of the debtor . . . if applicable law excuses a party . . . from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession.”²⁵³

The analysis set forth in the assumption prong also applies to the assignment prong. Under the patent nonassignability principle, the debtor-licensee does not have any property rights in the patent and, therefore, cannot assign the patent license to a third party without the licensor’s explicit consent.²⁵⁴ The identity of the third party—whether the third-party assignee is real or hypothetical—is irrelevant because in the absence of the licensor’s explicit consent, the debtor-licensee simply cannot make an assignment.²⁵⁵ Thus, the “applicable law” of patent nonassignability means the licensor does not have to accept perfor-

²⁵⁰ See *supra* Section I.A.

²⁵¹ See *Perlman v. Catapult Entm’t, Inc. (In re Catapult Entm’t, Inc.)*, 165 F.3d 747, 754-55 (9th Cir. 1999) (preventing the debtor from assuming the patent licenses); *In re W. Elecs. Inc.*, 852 F.2d 79, 83 (3d Cir. 1988) (“[I]n the context of the assumption and assignment of executory contracts, a solvent contractor and an insolvent debtor in possession going through bankruptcy are materially distinct entities.”). *But see* *Bonneville Power Admin. v. Mirant Corp. (In re Mirant Corp.)*, 440 F.3d 238, 248 (5th Cir. 2006) (citing cases in which courts have held that the solvent contractor and insolvent debtor-in-possession going through bankruptcy are not different entities for purposes of the antiassignment principle).

²⁵² See, e.g., *In re Catapult*, 165 F.3d at 750 (noting that section 365(c)(1) “bars a debtor in possession from *assuming* an executory contract without the nondebtor’s consent where applicable law precludes *assignment* of the contract to a third party”).

²⁵³ See 11 U.S.C. § 365(c)(1)(A) (2006).

²⁵⁴ See *supra* note 98 and accompanying text.

²⁵⁵ See *RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp.)*, 361 F.3d 257, 266 (4th Cir. 2004) (“Subsection (c)(1) bars assumption (absent consent) when ‘applicable law’ would bar an assignment.”); *In re Catapult*, 165 F.3d at 750 (“[T]he statute by its terms bars a debtor in possession from *assuming* an executory contract without the nondebtor’s consent”); *In re W. Elecs. Inc.*, 852 F.2d at 83 (“[T]he debtor in possession was not entitled to assume the contract without the [licensor’s] consent”).

mance from an entity other than the debtor or debtor-in-possession, thereby preventing the debtor from assigning the patent license.

Under a literal interpretation of the Code, section 365(c) forbids the debtor from either assuming or assigning the patent license. This prohibition would apply even where the debtor-in-possession has no intention of assigning the contract in question to any real third party.²⁵⁶

B. *The “or” as a Conjunctive “and”*

Critics of the hypothetical test argue that the disjunctive “or” must be read as a conjunctive “and.”²⁵⁷ Although these critics acknowledge that section 365(c) is, in fact, constructed in the disjunctive and by its plain language prohibits assumption *or* assignment, they maintain that the plain-meaning rule should not apply for three reasons: (1) the literal reading creates inconsistencies within the Code, (2) the literal reading is incompatible with the legislative history of section 365, and (3) the literal reading goes against sound bankruptcy policy.²⁵⁸ Instead, they argue that the proper interpretation of section 365(c) requires a case-by-case inquiry into whether the nondebtor’s contract will *actually* be assigned, or whether the nondebtor will *actually* be asked to accept performance from a third party other than the debtor or debtor-in-possession.²⁵⁹ As will be discussed, however, these arguments do not justify departing from the plain-meaning rule, and the literal reading of section 365(c) must prevail.

²⁵⁶ See *In re Sunterra*, 361 F.3d at 262 n.8 (finding the intent of the debtor-in-possession to assign to a third party irrelevant if the statute is read literally).

²⁵⁷ See *Bonneville Power Admin. v. Mirant Corp.* (*In re Mirant Corp.*), 440 F.3d 238, 249 (5th Cir. 2006) (adopting the actual test); *In re Sunterra*, 361 F.3d at 265-68 (detailing the argument that certain conflicts within the statute preclude a plain-meaning reading of the statute); *Summit Inv. & Dev. Corp. v. Leroux*, 69 F.3d 608, 612-13 (1st Cir. 1995) (preferring the actual test).

²⁵⁸ See *In re Catapult*, 165 F.3d at 751 (detailing the debtor’s arguments against the use of the plain-meaning rule); see also *Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489, 493 (1st Cir. 1997) (rejecting the hypothetical test in favor of a case-by-case approach); *Sullivan v. CIA*, 992 F.2d 1249, 1252 (1st Cir. 1993) (noting that “literal” interpretations that lead to absurd results should be avoided). *But see Leroux*, 69 F.3d at 610 (“Plain statutory language does not prompt recourse to countervailing legislative history.”).

²⁵⁹ See *In re Mirant*, 440 F.3d at 248 (emphasizing the importance of whether a contract will actually be assigned or whether a nondebtor will actually be forced to accept performance from a third party); *Leroux*, 69 F.3d at 612-13 (interpreting the legislative history to require “a case-by-case inquiry into the *actual* consequences . . . of permitting these executory contracts to be performed by the debtor party”).

1. Does the Literal Reading Create Inconsistencies?

a. *Section 365(c)'s Interaction with Section 365(f)(1)*

Proponents of the actual test contend that a literal reading of section 365(c) would implicate the absurdity exception to the plain-meaning rule of statutory interpretation.²⁶⁰ In order to achieve internal consistency, they argue, the court must interpret the statute so as to minimize discord among related provisions.²⁶¹ Specifically, they maintain that a literal reading of section 365(c) would render section 365(f)(1) inoperative and superfluous.²⁶²

Subsection (f)(1) provides that executory contracts, once assumed, may be assigned notwithstanding any contrary provisions contained in the contract or applicable law:

Except as provided in subsections (b) and (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection.²⁶³

The conflict arises from subsections (c)(1) and (f)(1)'s treatment of "applicable law." The plain language of subsection (c)(1) bars assumption whenever "applicable law" would bar assignment.²⁶⁴ Subsection (f)(1), however, states that executory contracts may be assigned, *contrary provisions in applicable law notwithstanding*.²⁶⁵ But, in order for a

²⁶⁰ See *Sigmon Coal Co. v. Apfel*, 226 F.3d 291, 304 (4th Cir. 2000) (noting that an exception to application of a statute's plain language exists when "a literal reading of a statute . . . results in an outcome that can truly be characterized as absurd, *i.e.*, that is 'so gross as to shock the general moral or common sense'" (citation omitted) (quoting Md. State Dep't of Educ. v. U.S. Dep't of Veterans Affairs, 98 F.3d 165, 169 (4th Cir. 1996))).

²⁶¹ See 2A NORMAN J. SINGER & J.D. SHAMBLE SINGER, STATUTES AND STATUTORY CONSTRUCTION § 46:6 (7th ed. 2007) ("A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant, and so that one section will not destroy another unless the provision is the result of obvious mistake or error." (footnotes omitted)).

²⁶² See *In re Sunterra*, 361 F.3d at 265-66 (discussing the "seemingly warring provisions of § 365(c)(1) and § 365(f)(1)"); *In re Catapult*, 165 F.3d at 751 (noting that "a literal reading of subsection (c)(1) appears to render subsection (f)(1) superfluous"); see also *Breeden v. Catron* (*In re Catron*), 158 B.R. 629, 636-37 (E.D. Va. 1993) (exploring the apparent conflict between subsections (c)(1) and (f)(1)); *In re Cardinal Indus., Inc.*, 116 B.R. 964, 976-77 (Bankr. S.D. Ohio 1990) (examining the trustee's argument that (c)(1) and (f)(1) conflict).

²⁶³ 11 U.S.C. § 365(f)(1) (2006).

²⁶⁴ *Id.* § 365(c)(1); see also discussion *supra* Section IV.A.

²⁶⁵ 11 U.S.C. § 365(f)(1).

contract to be assigned, the debtor must first assume it.²⁶⁶ A literal reading of section 365(c)(1) would thus render section 365(f)(1) inoperative and superfluous.²⁶⁷

The Sixth Circuit, however, reconciled the two provisions in *In re Magness*,²⁶⁸ noting that “each subsection recognizes an ‘applicable law’ of markedly different scope.”²⁶⁹ Subsection (f)(1) states the default rule by nullifying applicable law that “prohibits, restricts, or conditions the assignment of” an executory contract.²⁷⁰ Subsection (c), however, functions as an exception to this default rule.²⁷¹ As noted by one circuit court, “Thus, the ‘applicable law’ to which subsection (c) refers must mean ‘applicable law’ other than general prohibitions barring assignment.”²⁷² In fact, the exception under subsection (c) does not merely refer to law that generally bans assignment of executory contracts but instead that more specifically “excuses a party . . . from accepting performance from or rendering performance to an entity” other than the one with whom it originally contracted.²⁷³ The applicable law referred to in subsection (c) prevails over subsection (f)(1).²⁷⁴ As a result, the two subsections do not conflict. Under the default rule defined in subsection (f)(1), “applicable law” is law that

²⁶⁶ See *id.* § 365(f)(2)(A) (providing that the trustee may assign an executory contract if the trustee first assumes such a contract in accordance with the provisions of section 365).

²⁶⁷ See *In re Catron*, 158 B.R. at 636 (concluding that the “[c]onflict between subsections (c) and (f) of § 365 is inescapable”).

²⁶⁸ *Rieser v. Dayton Country Club Co. (In re Magness)*, 972 F.2d 689 (6th Cir. 1992).

²⁶⁹ *Id.* at 695; see also *City of Jamestown, Tenn. v. James Cable Partners, L.P. (In re James Cable Partners, L.P.)*, 27 F.3d 534, 537-38 (11th Cir. 1994) (noting that subsections (c) and (f) refer to different applicable law); *In re Antonelli*, 148 B.R. 443, 448 (D. Md. 1992) (stating that the distinction drawn in *In re Magness* is correct), *aff'd*, 4 F.3d 984 (4th Cir. 1993); *In re Lil’ Things, Inc.*, 220 B.R. 583, 590-91 (Bankr. N.D. Tex. 1998) (agreeing that (f)(1) states the general rule and that (c)(1)(A) is an exception to it).

²⁷⁰ See *In re Magness*, 972 F.2d at 695 (acknowledging subsection (f) as the default); see also *In re James Cable*, 27 F.3d at 538 (same).

²⁷¹ See 11 U.S.C. § 365(f)(1) (applying the default rule “[e]xcept as provided in subsection[] . . . (c) of this section”).

²⁷² *In re James Cable*, 27 F.3d at 538.

²⁷³ 11 U.S.C. § 365(c)(1)(A); see also *RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp.)*, 361 F.3d 257, 266-67 (4th Cir. 2004) (noting that subsection (c) recognizes a specific exception to the broad rule pronounced in subsection (f)); *In re James Cable*, 27 F.3d at 538 (holding that the applicable law referred to in subsection (c) does not include general prohibitions on assignments); *In re Magness*, 972 F.2d at 695 (asserting that subsection (c) refers to laws other than those generally prohibiting assignments).

²⁷⁴ *In re James Cable*, 27 F.3d at 538 (noting that subsection (c) permits diminishing the trustee’s power to assume or assign that is otherwise honored by subsection (f)).

generally prohibits or restricts assignments, while the “applicable law” provision of subsection (c) refers to “legal excuses for refusing to render or accept performance, regardless of the contract’s status as ‘assignable.’”²⁷⁵

To determine whether subsection (f)(1) nullifies a law prohibiting assignments, a court must inquire into *why* “applicable law” prohibits the assignment.²⁷⁶ Section 365(c) provides an exception to the default rule only where the law prohibits assignment of the contract on the rationale that the identity of the contracting party is material to the agreement and is therefore “non-delegable.”²⁷⁷ The federal common law principle of patent nonassignability states that a patent owner is not required to accept performance of the license from an entity other than the entity with which it originally contracted.²⁷⁸ This principle fits squarely within the exception given by section 365(c) because the identity of the debtor-licensee is, in fact, material to the underlying license.²⁷⁹ Accordingly, reading section 365(c) to prevent the debtor-licensee from assuming or assigning the patent license without the patent owner’s consent neither creates inconsistency with section 365(f)(1) nor renders subsection (f)(1) inoperative or superfluous.²⁸⁰

b. *Section 365(c)’s Interaction with Section 365(e)*

Proponents of the actual test also contend that a literal reading of section 365(c) is incompatible with section 365(e) of the Bankruptcy

²⁷⁵ *In re Magness*, 972 F.2d at 699 (Guy, J., concurring).

²⁷⁶ *See* *Perlman v. Catapult Entm’t, Inc.* (*In re Catapult Entm’t, Inc.*), 165 F.3d 747, 752 (9th Cir. 1999) (“[I]n determining whether an ‘applicable law’ stands or falls under § 365(f)(1), a court must ask *why* the ‘applicable law’ prohibits assignment.”); *In re Antonelli*, 148 B.R. 443, 448 (Bankr. D. Md. 1992) (discussing why a provision in the Uniform Partnership Act prohibits assignment in order to determine which subsection to apply), *aff’d*, 4 F.3d 984 (4th Cir. 1993).

²⁷⁷ *See In re Magness*, 972 F.2d at 700 (Guy, J., concurring) (arguing that section 365(c) sought to preserve contracts in which the identity of the original contracting party was material and there was a right of refusal); *In re Antonelli*, 148 B.R. at 448 (noting that section 365(c) applies “where contracts are held to be non-assignable because they impose upon the debtor duties which are said to be ‘non-delegable’”).

²⁷⁸ *See supra* Section III.A (discussing the federal common law principle of patent nonassignability).

²⁷⁹ *See supra* note 91 and accompanying text (concluding that a patent owner’s right to exclude includes the right to control its licensee’s identity).

²⁸⁰ *See* *RCI Tech. Corp. v. Sunterra Corp.* (*In re Sunterra Corp.*), 361 F.3d 257, 266-67 (4th Cir. 2004) (concluding that subsections (c) and (f) are not irreconcilable when applied to a software license agreement); *In re Catapult*, 165 F.3d at 752 (concluding that section 365(c) is not at odds with section 365(f)).

Code, which prohibits enforcement of ipso facto clauses in bankruptcy proceedings.²⁸¹ Section 365(e)(1)(B) states,

Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on . . . the commencement of a case under this title.²⁸²

Section 365(e) provides an exception to the general anti-*ipso facto* rule in subsection (e)(2)(A): “Paragraph (1) of this subsection does not apply to an executory contract . . . if (A)(i) applicable law excuses a party . . . *from accepting performance from or rendering performance to the trustee or to an assignee of such contract* . . . and (ii) such party does not consent to such assumption or assignment”²⁸³ Critics of the hypothetical test, which is premised on a literal reading, argue that the subsection (e)(2)(A) exception requires that the nondebtor party make an “*actual showing*—prior to any termination of the debtor’s postpetition contract rights—that the nondebtor party . . . would not be forced to accept performance under its executory contract from someone other than the debtor party with whom it originally contracted.”²⁸⁴ Thus, they argue that the hypothetical test is inappropriate because, unless the nondebtor party can make a showing of the debtor’s actual intent to assign the contract, the subsection (e)(2)(A) exception cannot be triggered.²⁸⁵ If the subsection (e)(2)(A) exception is not triggered, then the anti-*ipso facto* provision of subsection (e)(1)(A) will remain in effect, leaving the statute at odds with the anti-assignment provision of subsection (c)(1)(A).²⁸⁶

²⁸¹ See *Summit Inv. & Dev. Corp. v. Leroux*, 69 F.3d 608, 612 (1st Cir. 1995) (holding that “[a] proper construction of section 365(e)[] requires consideration of companion section 365(c)”).

²⁸² 11 U.S.C. § 365(e)(1)(B) (2006).

²⁸³ *Id.* § 365(e)(2)(A) (emphasis added).

²⁸⁴ *Leroux*, 69 F.3d at 612.

²⁸⁵ See *id.* (holding that the exception to the anti-*ipso facto* rule was only intended to prevent the nondebtor from being at the debtor’s mercy “by what *amounts to an actual* ‘assignment’”).

²⁸⁶ See *id.* at 613 (noting that if section 365(e)(2)(A) automatically terminated a debtor’s executory contract rights, the exception would conflict with subsection (c)(1)); see also *Bonneville Power Admin. v. Mirant Corp. (In re Mirant Corp.)*, 440 F.3d 238, 248-49 (5th Cir. 2006) (adopting the actual test because the alternative would create conflict with subsection (c)(1)).

Such an interpretation is premised on the notion that subsection (e)(2)(A) must be *actually* triggered. According to the statute, there are two situations in which the exception applies: (1) when applicable law excuses a party from accepting performance from or rendering performance to the *trustee*, and (2) when applicable law excuses a party from accepting performance from or rendering performance to an *assignee* of a contract.²⁸⁷

Supporters of the actual test argue that the subsection (e)(2)(A) exception does not apply in the context of patent licensing because “applicable law” does not excuse the nondebtor party from accepting performance from the *trustee*.²⁸⁸ This, however, is a faulty assumption when the “applicable law” in question is the federal common law principle of patent nonassignability. This principle protects a nondebtor licensor from having to accept performance of the license by an entity other than that with which it originally contracted.²⁸⁹ The prebankruptcy debtor, however, is not the same legal entity as the debtor-in-possession or trustee.²⁹⁰ Thus, the “applicable law” of patent nonassignability does, in fact, prevent a nondebtor licensor from having to accept performance from the debtor-in-possession or trustee. The nondebtor patent licensor, then, falls within the exception to the general prohibition on ipso facto clauses set forth in section 365(e)(2)(A).

Furthermore, the federal principle of patent nonassignability also implicates the second situation in which section 365(e)(2)(A) applies. The principle forbids the assignment of patent licenses without the explicit consent of the patent owner.²⁹¹ Thus, the “applicable law” of patent nonassignability also protects the nondebtor licensor from having to accept performance from an assignee of the license, because the debtor-licensee cannot assign the patent license without the consent of the nondebtor licensor.²⁹² The identity of the third-party assignee—whether real or speculative—is irrelevant, because the debtor-

²⁸⁷ 11 U.S.C. § 365(e)(2)(A)(i).

²⁸⁸ See *In re Mirant Corp.*, 440 F.3d at 248-49.

²⁸⁹ See *supra* note 91 and accompanying text (emphasizing that a patent owner’s exclusive right to an invention necessarily provides control over the identity of the performing party of a license).

²⁹⁰ See discussion *supra* Section II.D (recognizing that a prebankruptcy petition debtor is a different legal entity than a postbankruptcy petition debtor by reference to section 541(a)).

²⁹¹ See *id.* (describing the patent owner’s exclusive right to determine who receives an assignment).

²⁹² See *supra* note 91 (listing cases that recognize that licensees must get the licensor’s consent before assigning a license).

licensee simply cannot assign the license to a third-party assignee.²⁹³ There is no need to require an actual showing that the debtor-licensee intends to transfer the license to a third-party assignee, because the debtor-licensee cannot act without the licensor's consent. Based upon this protection, the federal common law of patent nonassignability also falls within the second situation in which the exception under section 365(e)(2)(A) applies.²⁹⁴ Accordingly, the anti-*ipso facto* provisions of section 365(e)(1) are not implicated.²⁹⁵

When the federal common law principle of patent nonassignability constitutes "applicable law" under section 365(e)(2)(A), both situations in which the exception to the general anti-*ipso facto* provision of section 365(e)(1) applies are met. The carve out in subsection (e)(2)(A) then protects the nondebtor party from having to accept performance from, or render performance to, a party with whom there was no original contract.²⁹⁶ Similar to the so-called "conflict" between section 365(e) and section 365(f), when the identity of the party from whom the nondebtor party must accept or to whom the nondebtor party must render performance is material, "applicable law" will protect the nondebtor party from having to honor the contract when the party is no longer the originally contracted party.²⁹⁷ As the courts have held, when "applicable law" serves to protect the nondebtor party in this specific manner, the provisions of section 365(c) will apply.²⁹⁸

²⁹³ See *RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp.)*, 361 F.3d 257, 271 (4th Cir. 2004) (holding that the license owner had not consented to assumption by a third party and that assumption was therefore invalid); *Perlman v. Catapult Entm't, Inc. (In re Catapult Entm't, Inc.)*, 165 F.3d 747, 750-51 (9th Cir. 1999) (emphasizing that without consent of the licensor, assignment to third party was invalid); *In re W. Elecs. Inc.*, 852 F.2d 79, 83 (3d Cir. 1988) (noting a debtor's inability to assign licenses to third parties unilaterally).

²⁹⁴ See 11 U.S.C. § 365(e)(2)(A) (2006).

²⁹⁵ See *id.* § 365(e)(1).

²⁹⁶ Cf. *In re Sunterra*, 361 F.3d at 262-63 (explaining that under one test but not the other, the licensor, would be held excused from its agreement to protect it from non-consensual assignment to a third party); *In re Catapult*, 165 F.3d at 750 ("[T]he statute by its terms bars a debtor in possession from *assuming* an executory contract without the nondebtor's consent where applicable law precludes *assignment* of the contract to a third party."); *In re W. Elecs.*, 852 F.2d at 83 (same).

²⁹⁷ See *Rieser v. Dayton Country Club Co. (In re Magness)*, 972 F.2d 689, 699-700 (6th Cir. 1992) (Guy, J., concurring) (finding that where the identity of the original contracting party was material, section 365(c) sought to preserve a right of refusal); *In re Antonelli*, 148 B.R. 443, 448 (D. Md. 1992) (noting that section 365(c) applies where contracts are held to be nonassignable because they impose upon the debtor duties which are said to be "non-delegable"), *aff'd*, 4 F.3d 984 (4th Cir. 1993).

²⁹⁸ See *In re Sunterra*, 361 F.3d at 262; *In re Catapult*, 165 F.3d at 750; *In re W. Elecs.*, 852 F.2d at 83.

Thus, there is no conflict between section 365(c), which prohibits the assignment of contracts, and section 365(e), which nullifies ipso facto clauses. Instead, section 365(c) operates in conjunction with section 365(e): when the section 365(e)(2)(A) exception is triggered, section 365(e)(1) no longer applies.

2. The Legislative History of Section 365

As a matter of statutory construction, when a statute is clear and unambiguous on its face, the Supreme Court has repeatedly stated that recourse to the statute's legislative history is inappropriate.²⁹⁹ A court can only look beyond an unambiguous statute to consult legislative history if a literal reading of the statute produces an outcome that is "demonstrably at odds" with clearly expressed congressional intent or results in an absurd outcome—one that is "so gross as to shock the general moral or common sense."³⁰⁰ Such instances, however, are exceptionally rare.³⁰¹ Generally, the courts have held that the intent of Congress as a whole is more apparent from the words of a statute itself than from a patchwork record of statements; there is a "strong presumption that Congress expresses its intent through the language it chooses."³⁰²

Proponents of the actual test argue that the literal reading of section 365(c) is at odds with the legislative history of the statute.³⁰³ Section 365(c), as it presently reads, was added to the Bankruptcy Code in the Bankruptcy Amendments and Federal Judgeship Act of 1984 (1984 Act).³⁰⁴ The 1984 Act was enacted primarily to rectify the con-

²⁹⁹ See, e.g., *Toibb v. Radloff*, 501 U.S. 157, 162 (1991) ("[T]his Court has repeated with some frequency: 'Where, as here, the resolution of a question of federal law turns on a statute and the intention of Congress, we look first to the statutory language and then to the legislative history if the statutory language is unclear.'" (quoting *Blum v. Stenson*, 465 U.S. 886, 896 (1984))).

³⁰⁰ *Crooks v. Harrelson*, 282 U.S. 55, 59-60 (1930); see also *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242 (1989).

³⁰¹ See *Tenn. Valley Auth. v. Hill*, 437 U.S. 153, 187 n.33 (1978) (explaining that courts should look beyond the text only in exceptional cases).

³⁰² *INS v. Cardoza-Fonseca*, 480 U.S. 421, 432 n.12 (1987).

³⁰³ See, e.g., *Bonneville Power Admin. v. Mirant Corp.* (*In re Mirant Corp.*), 440 F.3d 238, 249-51 (5th Cir. 2006) (adopting the actual test based on an interpretation of Congress's intent and the legislative history of section 365(c)). Where a court has adopted the hypothetical test, litigants often advocate for adoption of the actual test following a similar line of reasoning as the *Mirant* court. See *In re Sunterra*, 361 F.3d at 269-70 (stating that the proponent of the actual test argued that it was "'far more harmonious' with bankruptcy policy" and Congress's intent); *In re Catapult*, 165 F.3d at 753 (recalling that the litigants argued that the "legislative history requires disregard of the plain language of § 365(c)(1)" and thus the court should adopt the actual test).

³⁰⁴ Pub. L. No. 98-353, 98 Stat. 333.

stitutional crisis stemming from the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*³⁰⁵ It also served to address the Court's decision allowing bankruptcy trustees to reject collective bargaining agreements in *NLRB v. Bildisco & Bildisco*.³⁰⁶ Congress simultaneously took the opportunity to incorporate several other acts involving the Bankruptcy Code, many of which had been pending in Congress.³⁰⁷

Section 362(a) of the 1984 Act amended 11 U.S.C. § 365(c)(1)(A) by substituting the phrase "an entity other than the debtor or the debtor in possession" for the words "the trustee."³⁰⁸ There is, however, no legislative history for the 1984 Act relevant to section 365.³⁰⁹ Given the urgency with which the 1984 Act was passed, its legislative "history" is comprised solely of statements inserted, rather than actually read, into the Congressional Record.³¹⁰ Likewise, there is no authoritative legislative history for the 1984 versions of its component acts. The 1984 Act originated in a 1980 House amendment to an earlier Senate bill that sought to "correct technical errors, clarify and make minor substantive changes" to the Bankruptcy Reform Act of 1978.³¹¹ The 1980 House amendment was accompanied by "a relatively obscure committee report"³¹² stating,

This amendment makes it clear that the prohibition against a trustee's power to assume an executory contract does not apply where it is the debtor that is in possession and the performance to be given or received under a personal service contract will be the same as if no petition had been filed because of the personal service nature of the contract.³¹³

Courts that adopt the actual test in favor of the hypothetical test tend to rely upon this 1980 report for support.³¹⁴ According to them, the statement clearly indicates that Congress did not intend section

³⁰⁵ 458 U.S. 50 (1982).

³⁰⁶ 465 U.S. 513 (1984).

³⁰⁷ *In re Cardinal Indus., Inc.*, 116 B.R. 964, 978-80 (Bankr. S.D. Ohio 1990) (recounting the legislative history of the 1984 Act).

³⁰⁸ Compare 11 U.S.C. § 365(c)(1)(A) (1982), with Pub. L. No. 98-353, sec. 362(a), § 365(c)(1)(A), 98 Stat. at 362.

³⁰⁹ See *RCI Tech. Corp. v. Sunterra Corp.* (*In re Sunterra Corp.*), 361 F.3d 257, 270 (4th Cir. 2004) (explaining that there is no legislative history relevant to the alterations made to section 365 in the 1984 Act).

³¹⁰ 130 CONG. REC. 20,206-34 (1984); 130 CONG. REC. 20,080-94 (1984), reprinted in *COLLIER ON BANKRUPTCY* app. 4, pt. xx (Lawrence P. King ed., 15th ed. 1996).

³¹¹ H.R. REP. NO. 96-1195, at 1 (1980).

³¹² EPSTEIN ET AL., *supra* note 241, § 5-15, at 475.

³¹³ H.R. REP. NO. 96-1195, at 12.

³¹⁴ See, e.g., *Summit Inv. & Dev. Corp. v. Leroux*, 69 F.3d 608, 613 (1st Cir. 1995).

365(c)(1) to preclude assumption of an otherwise nonassignable personal service contract if “the performance to be given or received . . . will be the same as if no petition had been filed.”³¹⁵ Rather, they maintain that “§ 365(c)(1) provides that a debtor in possession can assume a personal service contract that is nonassignable . . . as long as its performance [would] be the same as if no petition had been filed.”³¹⁶

Furthermore, these courts note that the actual language of subsection (c)(1) says “the debtor or the debtor in possession” and not simply “the debtor in possession.”³¹⁷ To them, neither a debtor nor a debtor-in-possession is barred from assuming the underlying contract under section 365(c).³¹⁸ Accordingly, in their view, the hypothetical test is inappropriate because the debtor should not be prohibited from simply assuming the contract when Congress clearly intended to allow such an assumption.³¹⁹

A literal reading of the statute, however, does not produce an absurd outcome that is “demonstrably at odds” with its legislative history. The single statement made in the 1980 House amendment report is not enough to render the literal reading of section 365(c) improper.³²⁰ In general, a court should not look to the legislative history of a statute if there is no ambiguity in the statute’s plain language.³²¹ A court may only depart from the plain-meaning rule where the legislative history *clearly* indicates that Congress intended something other than what the statute actually says.³²² Even if legislative history suggests an interpreta-

³¹⁵ *Id.* at 613 (quoting H.R. REP. NO. 96-1195, at 12).

³¹⁶ *In re Cardinal Indus., Inc.*, 116 B.R. 964, 979 (S.D. Ohio 1990).

³¹⁷ *See* 11 U.S.C. § 365(c)(1)(A) (2006).

³¹⁸ *See Leroux*, 69 F.3d at 613.

³¹⁹ *See id.*

³²⁰ *See In re Cardinal*, 116 B.R. at 979 (acknowledging that “[s]ection 365(c) continues to bar the trustee from assuming a contract in those cases where applicable law excuses the nondebtor from accepting performance from the trustee”).

³²¹ *See, e.g., Davis v. Mich. Dep’t of Treasury*, 489 U.S. 803, 809 n.3 (1989) (“Legislative history is irrelevant to the interpretation of an unambiguous statute.”).

³²² *See City of Auburn v. United States*, 154 F.3d 1025, 1029 (9th Cir. 1998) (addressing the near-total exclusivity of unambiguous statutory language); *California v. Montrose Chem. Corp. of Cal.*, 104 F.3d 1507, 1515 (9th Cir. 1997) (“Because we conclude that the language of these sections is not ambiguous, we must follow the plain language of these sections unless the legislative history clearly indicates that Congress intended otherwise.”); *cf. Rust v. Sullivan*, 500 U.S. 173, 184 (1991) (holding that an administrative agency’s construction of a statute “may not be disturbed as an abuse of discretion if it reflects a plausible construction of the plain language of the statute and does not otherwise conflict with Congress’ expressed intent”); *Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988) (concluding that “where an otherwise acceptable construction of a statute would raise

tion contrary to a statute's plain meaning, that is "not necessarily sufficient to override the Plain Meaning Rule."³²³

Here, there is only a single statement, made in a "relatively obscure committee report,"³²⁴ that suggests any intent contrary to the literal reading of section 365(c). Further, this committee report was part of the legislative history of the 1980 House amendment, not the actual 1984 Act passed by Congress. As the record reflects, there is remarkably little, if any, legislative history that would enable definitive statements regarding Congress's intent. Thus, though the committee report's statement is worthy of consideration, it is not the sort of conclusive legislative history that would trump the plain language of the statute.³²⁵ There is no clear indication that Congress intended something other than the disjunctive "or" language of section 365(c). Had Congress intended the "or" to be read as a conjunctive "and," it would have written or amended the statute to read "assume *and* assign."³²⁶ Since Congress has not amended section 365(c) in this respect, a court is "not free to replace . . . [a statute's plain meaning] with an unenacted legislative intent."³²⁷ When the terms of a statute are clear and unambiguous, a court's inquiry ends, and it has the duty of enforcing the terms of the statute as Congress has drafted it.³²⁸

serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress").

³²³ RCI Tech. Corp. v. Sunterra Corp. (*In re Sunterra Corp.*), 361 F.3d 257, 270 (4th Cir. 2004); *see also* Sigmon Coal Co. v. Apfel, 226 F.3d 291, 306 (4th Cir. 2000) (declining to rely on legislative history to displace the plain meaning of a statute, particularly because such history consisted of only a statement made by a single member of Congress), *aff'd sub nom.* Barnhart v. Sigmon Coal Co., 534 U.S. 438 (2002).

³²⁴ EPSTEIN ET AL., *supra* note 241, § 5-15, at 475.

³²⁵ *See* Garcia v. United States, 469 U.S. 70, 76-78 (1984) (declining to allow "snippet[s]" of legislative history to undermine the statute's plain language); U.S. Dep't of State v. Wash. Post Co., 456 U.S. 595, 600 (1982) ("Passing references and isolated phrases are not controlling when analyzing a legislative history.")

³²⁶ *See* Russello v. United States, 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another . . . it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." (alteration in original) (quoting *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972))).

³²⁷ *United States v. Morison*, 844 F.2d 1057, 1064 (4th Cir. 1988) (quoting *INS v. Cardoza-Fonseca*, 480 U.S. 421, 453 (1987) (Scalia, J., concurring)).

³²⁸ *See, e.g.,* Lamie v. U.S. Tr., 540 U.S. 526, 534 (2004) ("[W]hen the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." (internal quotation marks omitted) (quoting *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000))); *Caminetti v. United States*, 242 U.S. 470, 485 (1917) ("[T]he sole function of the courts is to enforce [the statute] according to its terms.").

Furthermore, the literal reading of section 365(c) hardly results in an outcome that can be characterized as “absurd”—an outcome that “shock[s] the general moral or common sense.”³²⁹ The statute limits the trustee’s or debtor-in-possession’s power to assume or assign a contract by confirming the nondebtor’s rights under applicable non-bankruptcy law.³³⁰ This limitation prevents the trustee from assuming or assigning the contract because, in either case, the nondebtor party would be forced to accept performance by “an entity other than the debtor or the debtor in possession.”³³¹ Similarly, when the limitation is applied to the debtor party itself, the debtor-in-possession cannot assign the contract because the nondebtor party would still be forced to accept performance from a party with which it did not originally contract.³³² In the context of patent licensing, where the “applicable law” is the federal common law principle of patent nonassignability, these limitations are of particular importance due to the materiality of the licensee’s identity.³³³ Thus, the literal reading of section 365(c) does not result in an “absurd” outcome. Rather, the outcome protects the nondebtor party’s ability to receive “the full benefit of [its] bargain”³³⁴ were a third party to be substituted for the debtor from whom performance is sought.

As noted by several courts, the language of section 365(c) is clear and unambiguous.³³⁵ Nevertheless, even if the language left room for ambiguity such that a court should turn to the legislative history for

³²⁹ *Crooks v. Harrelson*, 282 U.S. 55, 59-60 (1930); *see also* *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242 (1989) (“The plain meaning of legislation should be conclusive, except in the ‘rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.’” (alteration in original) (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982))).

³³⁰ *See* *RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp.)*, 361 F.3d 257, 269-70 (4th Cir. 2004) (holding that the language of section 365(c) should be interpreted by literally reading its text because the legislative history does not conclusively indicate contrary intent).

³³¹ 11 U.S.C. § 365(c)(1)(A) (2006).

³³² *See id.* (preventing a trustee from assuming or assigning an executory contract if “applicable law excuses a party . . . from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession”).

³³³ For a discussion of the rationale behind the bar on assigning patents, *see supra* note 91 and accompanying text.

³³⁴ S. REP. NO. 95-989, at 59 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5845.

³³⁵ *See, e.g., In re Sunterra*, 361 F.3d at 265 (acknowledging that both parties agreed that a literal reading of the statute prohibits “assuming or assigning” an agreement); *Perlman v. Catapult Entm’t, Inc. (In re Catapult Entm’t, Inc.)*, 165 F.3d 747, 751 (9th Cir. 1999) (“Catapult urges us to abandon the literal language of § 365(c)(1) in favor of an alternative approach . . .”).

guidance, there is little evidence to suggest that the court should depart from the default rule of applying the statute's plain meaning. The literal reading of section 365(c) is neither at odds with its legislative history nor results in an "absurd" outcome that would "shock the general moral or common sense."³³⁶ Thus, there is no reason for a court to depart from the plain-meaning rule when interpreting the statute.³³⁷

3. The Literal Reading and General Bankruptcy Policies

Proponents of the actual test also contend that "a literal reading of [section 365(c)] conflicts with general bankruptcy policy, implicating the absurdity and intent exceptions to the [plain-meaning rule]."³³⁸ They maintain that the literal reading undermines "the general bankruptcy policy of fostering a successful reorganization and maximizing the value of the debtor's assets," because it undermines the debtor party's ability to restructure itself effectively.³³⁹ The literal reading of section 365(c) prevents a debtor party from assuming a patent license, even in situations where the debtor party has no intention of actually assigning the patent license to a real third party. Under the statute, the nondebtor licensor can compel rejection of the patent license. Without the ability to assume and continue using the license, the debtor loses a substantial asset that could seriously affect its ability to conduct business.³⁴⁰

Unsurprisingly, as the case law has demonstrated, bankruptcy courts tend to favor the actual test rather than a literal reading under the hypothetical test.³⁴¹ Nevertheless, even if there were merit to the

³³⁶ *Crooks v. Harrelson*, 282 U.S. 55, 59-60 (1930).

³³⁷ See *In re Sunterra*, 361 F.3d at 268 (noting that "[i]n assessing whether a plain reading of a statute implicates the absurdity exception, however, the issue is not whether the result would be 'unreasonable,' or even 'quite unreasonable,' but whether the result would be *absurd*").

³³⁸ *Id.* at 267-68; see also *In re Cardinal Indus., Inc.*, 116 B.R. 964, 976 (Bankr. S.D. Ohio 1990) ("The literal application of these provisions, argues the Trustee, makes no sense. Therefore, the [Trustee argues that the] Court must look to the legislative history and ascertain the intent of Congress."); 3 COLLIER ON BANKRUPTCY ¶ 365.06[1][d][iii] (Alan N. Resnick & Henry J. Summer eds., 15th rev. ed. 2009) (arguing that sound bankruptcy policy supports the actual test).

³³⁹ *In re Sunterra*, 361 F.3d at 268; see also *supra* notes 7-8 and accompanying text.

³⁴⁰ See, e.g., *Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489, 490-91 (1st Cir. 1997) (describing how the patent licenses in question were essential to the debtor's line of business).

³⁴¹ See, e.g., *Bonneville Power Admin. v. Mirant Corp.* (*In re Mirant Corp.*), 440 F.3d 238, 254-55 (5th Cir. 2006) (upholding the bankruptcy court's application of the actual test); *In re Sunterra*, 361 F.3d at 261-63 (noting that the bankruptcy court and

public policy argument against enforcement of the statute, “such arguments must necessarily fail in the face of an unambiguous statute.”³⁴² As noted by the Supreme Court, if poor policy choices produce undesirable results, it is up to Congress, *not the courts*, to amend the statute.³⁴³ Only Congress can modify a statutory provision to achieve a preferable policy outcome.³⁴⁴

Under the advocated actual test, the disjunctive “or” of section 365(c) would be read as a conjunctive “and,” thereby effectively reading the term “assume” out of the statute.³⁴⁵ Such an interpretation results in “the statute only prohibit[ing] assumption *and* assignment, as opposed to assumption *or* assignment.”³⁴⁶ Reading the “or” as a conjunctive “and” creates a much narrower exception under section 365(c)(1). Accordingly, the actual test’s interpretation affords the debtor party a much broader scope of protection than the literal reading of the statute provides. While this interpretation may be appealing from a bankruptcy policy perspective, a court “cannot adopt [such an interpretation] . . . without trespassing on a function reserved for the legislative branch.”³⁴⁷ A federal court’s function is limited to “determin[ing] the meaning of the statute passed by Congress, not whether wisdom or logic suggests that Congress could have done better.”³⁴⁸ Thus, even though a literal reading of the statute may not be

district court chose to apply the actual test instead of the hypothetical test); *In re Cataapult*, 165 F.3d at 755 (concluding that the bankruptcy court and district court erred in allowing the debtor-in-possession to assume the patent licenses in question); *Institut Pasteur*, 104 F.3d at 495 (affirming the bankruptcy court’s confirmation of a Chapter 11 reorganization plan which allowed the debtor-in-possession to assume the patent licenses in question).

³⁴² *Nelson v. George Wong Pension Trust (In re Nelson)* 391 B.R. 437, 452 (B.A.P. 9th Cir. 2008).

³⁴³ *See Lamie v. U.S. Tr.*, 540 U.S. 526, 542 (2004) (“If Congress enacted into law something different from what it intended, then it should amend the statute to conform it to its intent.”); *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 13-14 (2000) (“Achieving a better policy outcome . . . is a task for Congress, not the courts.”).

³⁴⁴ *See United States v. Noland*, 517 U.S. 535, 542 n.3 (1996) (“[I]t is up to Congress, not this Court, to revise the [policy] if it so chooses.”); *Union Bank v. Wolas*, 502 U.S. 151, 162 (1991) (“Whether Congress has wisely balanced . . . sometimes conflicting policies . . . is not a question that we are authorized to decide.”).

³⁴⁵ *See In re Cataapult*, 165 F.3d at 754 (holding that the actual test “effectively engrafts a narrow exception onto § 365(c)(1)” and pointing out that it “reads the word ‘assume’ out of subsection (c) with respect to debtors in possession” (citing *In re Fastrax, Inc.*, 129 B.R. 274, 277 (Bankr. M.D. Fla. 1991))).

³⁴⁶ *Id.*

³⁴⁷ *Sigmon Coal Co. v. Apfel*, 226 F.3d 291, 308 (4th Cir. 2000).

³⁴⁸ *Id.*

fully aligned with the goals of Chapter 11, a court cannot depart from the plain, unambiguous language of the statute simply because it disagrees with the policy effects of such an interpretation.

V. THE LITERAL READING AS A CREDITOR-PROTECTION MEASURE

Though advocates of the actual test argue that the literal reading undermines the goals of bankruptcy, the statute's effect on the competing interest in federal patent law is equally important. The American bankruptcy system operates in a specialized court, with its own set of rules set forth in the Bankruptcy Code.³⁴⁹ Because the umbrella of the Bankruptcy Code creates a unique relationship between debtors and creditors, the Code must focus on balancing the debtor's and creditor's interests.³⁵⁰ The literal reading of section 365(c)(1)(A) ensures that the federal patent interest of nonassignability is not rendered inoperative by the competing free-assignability principle of bankruptcy law.³⁵¹ In fact, the limitation set forth in section 365(c) is a creditor's *only* protection against the powerful free-transferability principle of section 365(f), which seeks to maximize the debtor's estate and facilitate reorganization.³⁵²

Without section 365(c), a patent owner would have no protection against an infringer who obtained a patent license from a bankrupt debtor-licensee. Once the infringer has acquired a license for the patented invention, the nondebtor patent owner no longer has the power to sue for infringement.³⁵³ Losing control over which entities it can sue effectively eliminates a patentee's right to exclude.

Within the context of section 365(c), the federal common law principle of nontransferability can be viewed as a creditor-protection measure. From an equitable perspective, a creditor patent owner should not be divested of its exclusive monopoly simply because its licensee,

³⁴⁹ These rules are codified in Title 11 of the United States Code. Congress passed the Bankruptcy Code under its Constitutional grant of authority to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." U.S. CONST. art. I, § 8, cl. 4.

³⁵⁰ For further discussion of these interests, see *supra* Section I.B.

³⁵¹ For a discussion of the factors that led to the inclusion of the patent clause in the U.S. Constitution, see Craig Allen Nard & Andrew P. Morriss, *Constitutionalizing Patents: From Venice to Philadelphia*, 2 REV. L. & ECON. 223, 299-304 (2006), available at <http://www.bepress.com/rle/vol2/iss2/art4>.

³⁵² See 11 U.S.C. § 365(c), (f) (2006).

³⁵³ See *supra* Section II.B (explaining that a patent license is merely a promise not to sue for infringement).

through no fault of the creditor patent owner, falls into bankruptcy.³⁵⁴ Furthermore, a creditor patent owner has economic incentives for wanting its patented technology to be readily available to consumers via the debtor-licensee.³⁵⁵ If the debtor-licensee can no longer meet this obligation, then the creditor patent owner should be free to reject the license and grant a new license to another entity that is better positioned to bring the end product to the market.³⁵⁶ Further, this exercise of control is consistent with Congress's treatment of patent policy and its intent to encourage innovation in exchange for the right to exclude, a proposition that forms the backbone of the American patent system.³⁵⁷ Under no circumstances should the creditor patent owner be compelled to allow a third party to use its license. Such compulsion would threaten to undermine the foundation of the entire patent system.³⁵⁸

A. *Patents Are a Property Right*

It has been settled for more than a century that the rights secured by a patent are property, and that patent property rights are no different in the eyes of the Constitution than any other property right.³⁵⁹ As the Supreme Court held in *Consolidated Fruit-Jar Co. v. Wright*, “[a] patent for an invention is as much property as a patent for land. The

³⁵⁴ See *Waterman v. Mackenzie*, 138 U.S. 252, 255 (1891) (“In equity, as at law, when the transfer amounts to a license only, the title remains in the owner of the patent . . .”).

³⁵⁵ For example, the creditor patent holder may wish to receive royalties or trade secrets based upon research, sale, or development of the patented invention.

³⁵⁶ Some critics argue that the literal reading of section 365(c) would provide a windfall for the nondebtor: if the debtor is outside of bankruptcy, then the nondebtor does not have the option to reject the license; if, however, the debtor files for bankruptcy, then the nondebtor can reclaim the license and potentially resell it at a higher market rate. See *N.C.P. Mktg. Group, Inc. v. BG Star Prods., Inc.*, 129 S. Ct. 1577, 1578 (2009) (denying petition for certiorari) (statement of Kennedy, J.) (discussing this possible windfall, along with competing concerns about the actual test, but concluding that this “is not the most suitable case for [the Court’s] resolution of the conflict”).

³⁵⁷ See *supra* Part II.

³⁵⁸ For example, in *Institut Pasteur v. Cambridge Biotech Corp.*, the circuit court allowed the sale of the debtor’s stock to a competitor of the creditor but refused to allow the creditor-licensor to reject the patent license. 104 F.3d 489, 493-94 (1st Cir. 1997). Effectively, this enabled the competitor to gain use of the licensor’s patented technology when the creditor would never have offered such a license in the first instance. See *id.* at 493 (noting plaintiff’s argument that “in substance” this was a cross-license to a “complete stranger”).

³⁵⁹ *Mach. Co. v. Murphy*, 97 U.S. 120, 121 (1877) (“Rights secured to an inventor by letters-patent are property . . .”); *Ethicon, Inc. v. U.S. Surgical Corp.*, 135 F.3d 1456, 1470 (Fed. Cir. 1998) (Newman, J., dissenting) (“The law of patent ownership has its roots in the common law of property . . .”).

right rests on the same foundation, and is surrounded and protected by the same sanctions.”³⁶⁰ For example, patent infringement constitutes a “taking” of patent property similar to a “taking” of real property.³⁶¹

A strong analogy can be drawn between a patent license, granting a right to invade the exclusive possession of patent property, and an easement over a piece of real property, granting the right to commit trespass.³⁶² Since the essence of trespass is the invasion of a person’s interest in the exclusive possession of land,³⁶³ the landowner may not bring an action for trespass against the person who has acquired an easement over the land in question.³⁶⁴ Similarly, a patent licensee can be viewed as one with an easement over the patent owner’s patent rights. In granting the licensee the “easement,” the patent owner forgoes the right to sue the licensee for patent infringement.

The holder of an easement, however, can commit an actionable trespass by exceeding its rights under the easement.³⁶⁵ For example, if the easement holder misuses or deviates from the easement, this can constitute unauthorized use.³⁶⁶ Likewise, if the easement is limited in scope or purpose, the easement holder can become a trespasser by

³⁶⁰ 94 U.S. 92, 96 (1876).

³⁶¹ See *Dowagiac Mfg. Co. v. Minn. Moline Plow Co.*, 235 U.S. 641, 648 (1915) (stating that “the exclusive right conferred by the patent [is] property and the infringement [is] a tortious taking of a part of that property”).

³⁶² “A ‘trespass’ occurs when there is an actionable interference with possession of land.” *Phillips v. Rathbone*, 93 P.3d 835, 839 (Or. Ct. App. 2004) (citing *Smejkal v. Empire Lite-Rock, Inc.*, 547 P.2d 1363 (Or. 1976)).

³⁶³ See, e.g., *Poff v. Hayes*, 763 So. 2d 234, 240 (Ala. 2000) (clarifying that trespass “is a wrong against the right of possession” (quoting *Jefferies v. Bush*, 608 So. 2d 361, 362 (Ala. 1992))); *Munsey v. Hanly*, 67 A. 217, 217 (Me. 1907) (“The gist of the action of trespass . . . is the disturbance of the possession.”); *Lane v. Mims*, 70 S.E.2d 244, 246 (S.C. 1952) (noting that “the action of trespass . . . is founded upon possession”); *Austin v. Hallstrom*, 86 A.2d 549, 549 (Vt. 1952) (“The gist of the action of trespass upon the freehold is the injury to the possession.”).

³⁶⁴ See, e.g., *Simcox v. Hunt*, 874 So. 2d 1010, 1018-19 (Miss. Ct. App. 2004) (explaining that easements confer a right of use and trespass requires entrance without a right).

³⁶⁵ See, e.g., *Tice v. Herring*, 717 So. 2d 181, 182 (Fla. Dist. Ct. App. 1998) (explaining that the “burden of [an] easement . . . may not ordinarily extend beyond that which was reasonably contemplated with the creation of the easement”); *Schadewald v. Brulé*, 570 N.W.2d 788, 795 (Mich. Ct. App. 1997) (noting that a party cannot unilaterally increase the burden of an easement); *Reinbott v. Tidwell*, 191 S.W.3d 102, 109 (Mo. Ct. App. 2006) (explaining that if an easement holder exceeds his right of use “he is guilty of trespass” (quoting *Smith v. Woodard*, 15 S.W.3d 768, 773 (Mo. Ct. App. 2000))).

³⁶⁶ See, e.g., *Apel v. Katz*, 697 N.E.2d 600, 607 (Ohio 1998) (affirming a jury verdict that a person who had a roadway easement across adjacent property, but had used a portion of the property outside the easement, had trespassed).

exceeding the bounds of the easement.³⁶⁷ Most important to the issue at hand, real property also recognizes that the existence of an easement does not justify an entry by a trespassing third party.³⁶⁸

Similar to an easement in real property, a patent license limits the scope and use of the licensee, and any deviation from the license constitutes an act of infringement.³⁶⁹ Additionally, as with an easement, a patent owner is protected from unauthorized infringement by “a trespassing third party” through injunctive relief.

B. *Patent Law’s Injunctive Relief Against Infringers*

The patent system’s reward of injunctive relief against patent infringers further justifies allowing a creditor patent owner to compel the rejection of a license. Prior to the Supreme Court’s decision in *eBay Inc. v. MercExchange, L.L.C.*,³⁷⁰ a patent owner was automatically granted an injunction preventing the infringer from continuing to make, use, or sell the patented technology upon a finding of infringement.³⁷¹ Even after *eBay*, although a permanent injunction does not automatically follow from a finding of infringement, a patent owner can still obtain a permanent injunction if it satisfies the four-factor test historically employed by courts of equity.³⁷² Thus, the creditor patent owner’s right to prohibit assumption or assignment of the license is similar to a patent owner’s right to obtain an injunction against infringers. Both remedies operate as an equitable form of

³⁶⁷ See, e.g., *Conner v. Lucas*, 920 P.2d 171, 175 (Or. Ct. App. 1996) (finding that planting trees on a roadway easement was a trespass because this use was inconsistent with the use of the property as a roadway).

³⁶⁸ See, e.g., *Tusa v. Cablevision*, 691 N.Y.S.2d 105, 106 (App. Div. 1999) (holding that where a utility easement was for the benefit of homeowners in a subdivision, the installation of a line for the benefit of an owner outside the subdivision was a trespass).

³⁶⁹ Cf. *Conner*, 920 P.2d at 175 (finding the defendant liable for misuse of an easement).

³⁷⁰ 547 U.S. 388 (2006).

³⁷¹ See *MercExchange, L.L.C. v. eBay, Inc.*, 401 F.3d 1323, 1339 (Fed. Cir. 2005) (noting the “general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances”), *vacated*, 547 U.S. 388.

³⁷² See *eBay*, 547 U.S. at 391 (detailing the four-factor test). A recent study published in *IPToday.com* found that, post-*eBay*, district courts were still granting injunctive relief over seventy percent of the time. See Ernest Grumbles, III, Rachel C. Hughey & Susan Perera, *The Three Year Anniversary of eBay v. MercExchange: A Statistical Analysis of Permanent Injunctions*, INTELL. PROP. TODAY, Nov. 2009, available at <http://www.iptoday.com/issues/2009/11/articles/three-year-anniversary-eBay-MercExchange.asp> (finding that out of 67 district court injunction decisions, 48 (72%) granted relief while 19 (28%) denied relief).

protecting the fundamental right to exclude, which is embodied in the federal common law principle of patent nontransferability.

The development of patent law has a historical foundation in real property. Further, the Constitution recognizes the importance of strong patent protection in order to foster innovation and development for the public.³⁷³ In a bankruptcy proceeding, however, this federal patent interest is weighed against the competing interests of general bankruptcy policies. Although those who criticize a literal reading of section 365(c) argue that such a reading undermines the general goals of bankruptcy, they overlook the importance of balancing the other federal interests at stake—namely, those of patent law. Thus, while a literal reading of the statute may not protect the debtor to the fullest extent possible, it best protects the creditor patent owner.

CONCLUSION

There is an inherent tension between the federal common law principle of patent nontransferability and the free-transferability principle codified in section 365(f) of the Bankruptcy Code. Because the federal principle of patent nonassignability protects the nondebtor licensor from having to accept performance from, or render performance to, an entity other than that with which it originally contracted, it falls under the “applicable law” exception of section 365(c). Courts have struggled to reconcile these two competing interests. Courts have developed two main tests in applying these provisions: the hypothetical test, which takes a literal reading of the statute, and the actual test, which overrides the literal reading of the statute in favor of the general goals of bankruptcy policy. Some members of the Supreme Court have recognized the need to reconcile these two competing approaches.³⁷⁴ To date, however, the Court has not found a suitable case for addressing this question, leaving the issue to the lower courts for now.³⁷⁵

³⁷³ See U.S. CONST. art. I, § 8, cl. 8; *supra* Part II.

³⁷⁴ See *N.C.P. Mktg. Group, Inc. v. BG Star Prods., Inc.*, 129 S. Ct. 1577 (2009) (denying petition for certiorari) (statement of Kennedy, J.).

³⁷⁵ Justice Kennedy recognized the importance of finding a suitable case:

The division in the courts over the meaning of [section] 365(c)(1) is an important one to resolve for Bankruptcy Courts and for businesses that seek reorganization. This petition for certiorari, however, is not the most suitable case for our resolution of the conflict. . . . In a different case the Court should consider granting certiorari on this significant question.

Id. at 1578.

After *In re Footstar*, some courts have departed from the two traditional tests. These courts have instead taken a third view, opting to apply neither the hypothetical test nor the actual test but ultimately reaching the same outcome that would result under the actual test. Despite this, some commentators believe that *In re Footstar* and its progeny offer a middle ground between the hypothetical and actual tests.³⁷⁶

The courts that have adopted the actual test overlook the importance of the nondebtor's patent rights—rights that should be placed at the forefront as a protective measure against the debtor-friendly broad power of free transferability. In considering the justifications for adopting a particular interpretation of the statute, these courts should consider, in addition to the general goals of bankruptcy, the competing interests of federal patent law.

An examination of the plain language of the statute clearly indicates that the hypothetical test is the correct approach, even if it is not as favorable to the debtor-licensee. Furthermore, the legislative history of the statute does not justify departing from the plain-meaning interpretation of the statute. Finally, the hypothetical test better protects the patent interest of the nondebtor licensor by prohibiting assumption or assignment of the patent license.

³⁷⁶ See, e.g., Kuney, *supra* note 17, at 154 (“It may . . . strike the correct balance between the needs of owners and licensees.”).